330.0000 LEASES OF TANGIBLE PERSONAL PROPERTY—IN GENERAL—Regulation 1660
Banks and insurance companies, leases by, see also Banks and Insurance Companies. Delivery charges in lease transactions, see also Transportation Charges. Interstate leasing, see also Interstate and Foreign Commerce. Leased premises, sale of property attached to, see also Buildings and Other Property Affixed to Realty. Studio rentals, see also Sound Recording. Use, leasing as, see also Use of Property in State and Use Tax Generally.

(a) IN GENERAL

330.1820 **Additional Charges for Loss and Damage.** A lessor of steel piling leased the piling under an agreement which provided that the lessee pay additional compensation for damage to the piling and for piling which the lessee could not remove from the ground and return to the lessor. The lessee had no right to retain usable piling. The additional charges for damage and loss of piling were not taxable rental charges. 10/21/65.

330.1830 **Advance Rental Payments.** Advance rental payments received by the lessor at the time the lease commences are subject to the tax at the time the amounts are paid by the lessee in accordance with section 6203. It is immaterial that the advance rental payment is designated as being applicable to the final period of the lease. 3/25/69.

330.1840 **Agreement to Treat Fixtures as Personal Property.** Corporation A operates department stores in California. It entered into an agreement to sell certain store properties to Corporation B. Corporation C was a trust operating under the direction of Corporation B. Corporation B provided the funds for the transaction to Corporation C and was the owner of the trust. Under this agreement, Corporation C purchased stores from Corporation A, and leased the land upon which the stores were located from Corporation A. Corporation C then leased the stores and subleased the land to Corporation A as owner/trustee. Corporation A had the option to renew the lease and also had the right of first refusal in the event that Corporation B decided to sell the property.

The agreement between Corporation A and Corporation B provided that certain materials and fixtures incorporated into the realty were to remain tangible personal property for income tax and security purposes.

The agreement cannot change the character of the property. The lease of the materials and fixtures is not, in fact, a lease of tangible personal property. Section 6016.3 of the Revenue and Taxation Code does not apply because the lessor of the fixtures is also the lessor of the realty. Tax does not apply to the lease of items identifiable as materials and fixtures. 4/25/94.

330.1860 **Aircraft—Student Flight Instruction.** Student flight instruction is ordinarily considered to be a use of the aircraft by an owner-instructor. If the aircraft is never leased to a qualified pilot, and is used for instructional purposes only, the student is regarded as obtaining the service of in-air flight instruction. As such, the transaction is not a lease because true possession and control over the aircraft is not transferred to the student.

On the other hand, if the aircraft is available for lease to any qualified pilot, and the student is charged a rental fee in the same amount as that charged to any lessee with a separate charge added for instruction, then the transaction is regarded as a true lease plus flight instruction. 5/13/94.

330.1870 **An Amount Fixed by the Lease.** An amount fixed by the lease for purposes of an exemption from a tax rate increase or an exemption from a new tax means that the total amount due under the lease, including the amount of use tax due on the rental payment, is specifically fixed. A provision in the lease agreement providing that the amount itemized for tax is ‘‘estimated,’’ or a provision in the lease agreement that provides that the lessee will pay to the lessor the applicable tax, means that the payment due from the lessee is not for an amount fixed by the lease and the lease would therefore not qualify for the exemption. Since the tax rate applicable to a lease is the rate in effect at time of use, a provision for the lessee to pay the lessor applicable taxes shows that the parties have contemplated that the rate may change and have provided for the lessee to pay to the lessor the tax applicable at the time of use. 12/2/91.

330.1873 **Assignment of Lease.** When a lease that is a ‘‘sale’’ and ‘‘purchase’’ is assigned, the rental payments remain subject to tax. Whether the assignor or assignee is responsible for collection and payment of tax depends on the nature of the assignment. If the assignment merely creates the right to collect the rental payments and creates a security interest, the lessor (assignor) remains responsible for collecting and paying the tax. If the assignment is an assignment of the lease contract together with the transfer of the right, title, and interest in the leased property for security purposes, the assignee is required to collect, report, and pay the tax. If the assignment is of the lease contract, together with the transfer of all right, title and interest of the leased property and there is no recourse by assignee against the assignor, the assignee assumes the position of the lessor and must collect, report, and pay the tax on the rental receipts. 2/27/90.

330.1874 **Assignment of Lease.** An owner of property sells it and leases it back in a transaction qualifying as an acquisition sale and leaseback under section 6010.65. That person, now a lessee, assigns the lease to a new sub-lessee. If the leaseback portion of the acquisition sale and leaseback transaction is a true lease (as opposed to a sale at inception), then no tax applies to the rentals paid by the sub-lessee and the assignment is not taxable. However, the exercise of an option to purchase the leased property by the sub-lessee would be subject to tax. On the other hand, if the leaseback portion is a sale at inception, the assignment of the ‘‘lease’’ is actually a sale of the property to the sub-lessee. As such, the assignment/sale is taxable; however, the ‘‘lease’’ receipts paid by the sub-lessee would not taxable. 2/21/92; 4/1/94.

330.1874.040 **Assignment of Leases.** Company A (who is basically a financing company) enters into a loan and security agreement with the lessor/borrower C for the first three types of agreements. These loan and security agreements provide the property to be leased will be security for the loan and that the rentals will, in effect, be used to pay the amounts due under the loan. In addition, Company C executes a loan receipt for each loan. Company A has the authority, but not the obligation to collect tax on the rentals. Company C does not have personal liability for the loan except under certain specified circumstances.

(1) Company C assigned to Company A all of its rights and remedies and all rentals and other sums due and to become due, except the purchase option. At the end of the lease agreement the lease option reverts back to Company C for exercise of the option. Company A is the one collecting and billing all the rentals and the tax. Company A sells its loan receipt to a Trust Company B and assigns to Company B all the rights and remedies.

Initially, it appears that title to the property was not transferred to Company A except for purposes of security. Although Company B could serve a copy of the assignment on the lessee, it appears that Company B did not do so and the lessee was not notified. Based on the documents submitted, it is concluded that the assignment to Company A was of rental income with Company C retaining the obligations of the lessor. Therefore, Company C is obligated to collect and report the tax even though rentals are paid to Company A. Since Company A assigned Company B only those rights in the lease contract that had been assigned to Company A by Company C, Company C remains obligated to collect and report the tax.

(2) Companies A and C entered into the general loan and security agreement which refers to a purchase money security interest in leased equipment. Company C executed a loan receipt which refers back to the loan and security agreement and indicates that Company A has a purchase money security interest in the equipment. Company C executed an assignment of lease in which it assigned to Company A ‘‘all of its right, title and interest in, to and under, but not its obligations under, the above-referenced lease . . . , including without limitation the leased equipment . . . ’’ Company A, in turn, makes an assignment (with similar language) to Company B.

The language in the assignments indicates that full title to the equipment was transferred to Company A and then to Company B. However, the language in the loan receipt is directly contrary in that it transfers only a security interest in the equipment. Furthermore, other language in the lease assignments, quoted above, retains obligations under the lease to Company C. That is, not all right, title and interest was transferred.

It appears that Company A drafted the documents. The general rule of construction is to construe ambiguities in contracts against the drafter. Applying this rule, Company C transferred to Company A only a security interest in the equipment together with an assignment of the rental income from the lease. Company C retained the obligations of lessor under the lease agreement. In addition, Company A could assign to Company B only what it had. The tax application is the same as situation (1) above.

(3) Company C assigns Company A all the rights and remedies. A does all the billing for the rentals and the tax. Company A in turn assigns to Company B ''all right, title and interest . . . ''

Company A cannot assign to Company B more than it has. The situation is similar to situation (1) above with Company C being responsible for the tax.

(4) Company A is the original lessor and assigns the right to receive the rental income to a bank. Company A also grants the bank a security interest in the leased property.

In this situation, Company A, the original lessor, owes any tax due.

In conclusion, in all the above situations, the original lessor would owe any additional tax due. However, if the lessor elects to pay sales tax reimbursement or timely pay use tax measured by the purchase price, the leases would not be continuing sales and purchases and would not be subject to tax. Accordingly if the assignment were merely of the rental stream and not a sale of leased property, there would not be any sales or use tax. If there was a sale of the leased property, that sale would be subject to sales tax measured by gross receipts. 2/26/88.

330.1874.055 **Assignment of Lease to Titling Trust.** A motor vehicle dealer transfers to a titling trust vehicles which are being leased. Regardless of how the parties characterize the transaction (e.g., an assignment of the leases, a sale subject to leases, or a sale of the property and an assignment of the leases), this type of transaction is a sale of the property and an assignment of the leases. The sale is subject to tax unless the leases are continuing sales. If so, the purchaser (the titling trust) is purchasing the property for resale and must hold a seller's permit, collect tax on rentals payable, and report and pay that tax to the Board. 06/27/96.

330.1874.100 **Automobiles Provided to Employees.** A wholly owned subsidiary not engaged in either the manufacture or sale of automobiles, issued a resale certificate to its parent company that is engaged in the manufacture of automobiles. It purchased vehicles from the parent company without payment of tax and assigned them to high ranking employees for personal use in exchange for a monthly payment of 1.73% of the cost of the auto. The autos are returned by the employees after 10,000 miles of use. The employees are required to submit a product evaluation form. The subsidiary pays use tax on the amount paid by the employees and also pays for the repairs, maintenance, insurance, and license fees.

These transactions are not bona fide lease agreements and the autos should not be purchased under resale certificates as they were not purchased for resale in the regular course of business. The amount paid by the employees is about ⅓ of the market rental rate, the use of autos is available only to employees at a certain level in hierarchy, the amount to be paid is not negotiated but dictated by the taxpayer, and the employee does not bear the ordinary expenses associated with the lease of an auto. These agreements are essentially fringe benefits for employees high up in the organization, and tax is due on the purchase price. 8/12/92.

330.1874.200 **Bank Documentation Fees.** A bank enters into agreements with various car dealers to lease vehicles to customers obtained by the various car dealers. The dealers secure approval of the potential lessees from the bank and prepare the lease contracts which show the bank as the lessor. The drive-off costs to a customer includes the first month's lease amount, DMV fees, cap reduction, and a $400 bank documentation fee. The vehicles are registered in the name of the bank and the lessees.

The documentation fees are charges required to be paid by the lessees under the term of the leases and are related to the taxable sales (leases) of tangible personal property. Assuming that the fees are remitted to the bank by the dealers (or netted by the bank from the payment for the vehicle to the dealers), the

documentation fees should be included in the bank's gross receipts and the rental charges are subject to tax. 7/16/92; 5/20/96.

330.1874.750 **Early Buyout on Tax-Paid Lease.** Upon a lessee's exercise of an option to purchase leased equipment, irrespective of whether the lease is a tax-paid lease or a continuing purchase and sale, the entire amount paid to the lessor/seller for the equipment is subject to tax, whether that buyout amount is determined with reference to what would otherwise have been lease payments or determined in any other manner. 2/2/98. (M99–2).

330.1875 **Equipment Leasing.** Corporation A acquires the equipment it will rent from its out-of-state sister organization, Corporation B, and subleases the equipment to its lessees. Corporation A pays Corporation B a rental fee based on a percentage of the rentals received by Corporation A. The timely payment of use tax measured by rentals payable to Corporation B would mean that the sublease of the leased equipment would not be a continuing sale and would not be subject to use tax. Since the corporations are related parties, further analysis is required to determine if the lease is an arms length transaction. If the rentals payable under that lease covers all costs of the lessor with respect to that lease, it is generally regarded as being entered into as if at arms length and considered the same as a lease between unrelated parties. 7/8/92.

330.1876 **Assignment Sale of Leased Property and Assignment for Lease.** A manufacturer/lessor of tangible personal property, reporting tax on a rental receipts basis, plans on selling its lease inventory to a subsidiary. In order for the transaction to be recognized as a sale for sales and use tax purposes, the transaction must be at arm's length.

The property transferred will be sold subject to existing leases. The leases generally average six weeks in length, but can be canceled at any time by the customer. Accordingly, even if the transaction is at arm's length, since the property is sold subject to existing taxable leases, the subsidiary would not have the option to pay tax on the purchase price rather than the rentals receipts. (See Regulation 1660(c)(9)9A.) However, the subsidiary could have an election to pay tax on purchase price if the following steps were taken:

(1) The original lessor/assignor must notify the lessees that the leases will terminate at a specified time, assuming the rental agreements permit this.

(2) The lessees would have to contract with the new lessor/assignee for a new lease to commence at that same specified time.

(3) The sale of the leased property to the subsidiary occurs at the same specified time.

If these transactions do not occur simultaneously, the leased property remains subject to the existing taxable leases at the time of the sale and tax would continue to be due measured by rentals payable. 5/30/91.

330.1878 **Assignments.** In sales and use tax matters, the language used by the parties to characterize their transaction does not in itself necessarily control. Therefore, despite the language of assignment contracts, a taxable sale occurred if other evidence indicated that title in fact passed from transferor to transferee. Such other evidence would include the following factors:

(1) Whether transferor or the transferee retained title in the property after the payments to the transferee were completed;

(2) Whether the parties filed financing statements under the Uniform Commercial Code;

(3) Whether the parties treated the transaction as a sale or a loan for income tax purposes, and, more specifically, whether the transferor or the transferee claimed depreciation, investment tax credit, or similar deductions predicated upon ownership of the property; and

(4) Whether the putative interest rate, if the transaction were treated as a loan, would be usurious under California law. 1/16/87.

330.1880 **Audio Tapes.** A lease of an audio tape does not come within the exclusion of section 6006(g)(1). 11/20/69.

330.1885 **Automobile Provided to Employee.** A corporation provides an automobile to an employee as part of his/her compensation package. The auto is purchased tax-paid and is given to the employee at the end of four years. One fourth of the total cost of the auto is added to the employee's FormW-2 each year. The employee may terminate his/her employment at will. If this occurs, the automobile may be acquired at an option price based on the number of years remaining before the four year period ends, e.g. if termination occurs at the end of the first year the employee pays 75 percent of the acquisition cost of the vehicle.

In this case, the transaction is regarded as a lease of tax-paid property, and since the vehicle is leased to the employee in the same form as acquired, the rent is not subject to tax.

At the end of four years the vehicle is given to the employee, with no payment required to obtain title. As such, there is no sale to the employee and therefore no tax liability. If the employee quits during the four year period and pays an amount in order to keep the car, a sale occurs. Provided the corporation is not a licensed automobile dealer, the employee must pay use tax to DMV measured by the amount paid. If the corporation is a licensed dealer, the corporation is liable for the sales tax on the amount paid by the employee. 9/24/93.

330.1900 **Boats—Lease Contracts.** A person purchases a marina including boats, and the transaction is exempt under section 6281.

(a) Tax will apply to receipts from rentals of the boats.

(b) Taxpayer has no election to pay sales tax in lieu of tax on the rental receipts since he cannot elect to pay tax on a transaction that is exempt under the law.

(c) If the transaction is not exempt under section 6281 and the purchaser pays use tax to the Board, he may rent the boats without sales or use tax liability.

(d) If the transaction is not exempt under section 6281, but the purchaser has a seller's permit, he may elect to report and pay tax on the receipts from boat rentals. 10/5/65.

330.1908 **Book Rentals.** A taxpayer publishes annual compilations of real estate owners, purchasing the printing and all other components tax paid from the printer. The agreement with each subscriber provides that the transaction is a lease and that the book remains the property of the publisher. The previous year's edition is picked up when the new edition is delivered. The agreement and the publisher's method of operating confirm that the transactions are leases. Since the books are purchased tax paid and leased in the form in which they are acquired, tax does not apply to the charges to subscribers. 11/13/68.

330.1920 **Burglar Alarms—Lease Contracts.** Contracts for the installation and service of burglar alarms may be regarded as service agreements rather than leases of tangible personal property in those cases in which: the value of the equipment on the customer's premises is low in comparison to the total charge; the installation by the burglar alarm company does not constitute substantial fabrication labor; the company has the right to change or alter the equipment as it deems necessary to provide the proper alarms; and the company goes to the customer's premises after each alarm. The burglar alarm company will be regarded as the consumer of all property it uses or installs under those contracts. 5/26/66.

330.1933 **Business Location of Lessor.** The rental of boats or boats and outboard motors purchased ex-tax by the concessionaire on a lake are subject to tax because, although many of the rentals may be for less than a 24 hour period and for less than $20.00, the use of the boats is not limited to a specific area owned or leased by the lessor of the boats and motors. Members of the general public are allowed to sail private boats

on the lake without permission of the concessionaire, indicating that the concessionaire does not have the exclusive right to use the premises (lake) as required for exemption under Regulation 1660(e). 6/14/85.

330.1940 **Control.** The providing of animals for performance and exhibition, with the animal's owner always accompanying the animal and retaining control of the animal, does not constitute a lease of the animals. For a lease to occur, the tangible personal property must be under the direction and control of the lessee. When the animal owner retains direction and control, the customer has not leased the animals but, rather, has engaged the services of the owner and the animals. 7/7/69; 1/14/86. (Am. 2001–3).

330.2001 **Cable Television—Remote Control Units and Converters.** Cable companies are lessors of remote control units and converters which they provide to customers for a separately stated amount. The separate statement indicates an intent to lease. 12/6/84. (Am. 2005–2).

330.2010 **Capitalized Cost Reduction.** Under a long-term lease of a motor vehicle, a lessee may pay a number of fees including the first month's rent and an initial sum of money called a ''capitalized cost reduction.'' The effect of the capitalized cost reduction is to reduce the amount of the rental, normally payable by the lessee. Such payments are in the nature of advanced rental payments and subject to tax. 1/6/89.

330.2019 **Cap and Gowns.** Generally, a lease of collegiate caps and gowns to a university for one year does not include a recurring laundry provision despite the fact that students anticipate a clean cap and gown. On the other hand, in the case of a lease for more than a year, it is assumed that recurring laundry service is provided as essential part of the lease and, thus, such leases are excluded from the definition of a sale by section 6006(g)(2) and the lessor is the consumer of the caps and gowns. 6/2/82.

330.2020 **Caps and Gowns.** Rentals of caps and gowns are not within the exclusion provided in section 6006(g)(2), inasmuch as the furnishing of recurring laundering or cleaning is not an essential part of the lease agreement. 3/11/68.

330.2021 **Change Reporting Basis.** When a lessor paid neither sales tax reimbursement nor use tax on the equipment at the time of the purchase and did not timely elect to pay the use tax with its return for the period during which the equipment was first placed in rental service, the lease of the equipment by the lessor is a continuing sale and purchase. The lessor is not permitted to later elect to pay tax measured by the purchase price of the equipment, but rather is obligated to collect use tax from its lessees as measured by the rental receipts derived from the leases of the equipment. (Regulation 1660(c)(1).) 1/22/96.

330.2022 **Change to Tax-Paid Status.** Company A and Company B are both in the business of leasing equipment in substantially the same form as acquired to the general public. Both companies are owned by Company C. Company A purchased its equipment ex-tax and has been reporting and paying tax on the rental receipts. It now finds this arrangement undesirable and wishes to convert to tax-paid status. It sells all of its equipment to Company B in a taxable sale at fair market value and collects and pays sales tax reimbursement on the transaction. It then leases the equipment back from Company B, which has no liability on this lease because the equipment is now tax-paid and being leased in the same form as acquired. The subsequent sub-lease by Company A to the general public is also not subject to tax for the same reason. 11/22/83.

330.2030. **Charges for Lost Photographic Slides.** A customer lost five photographic slides that were leased. The lessor of the photographic slides charged the lessee $1,500.00 for each slide that was lost.

The charges were analogous to charges made by a lessor for insuring, repairing, or refurbishing leased property following a default. Accordingly, the transactions did not result in the sale of the slides. 6/14/93.

330.2040 **Chartered Fishing Trips.** The purchase of an individual ticket for a fishing trip from a charter boat operator establishes a contract for carriage rather than a rental of the boat. Where fishing tackle is rented for use on the boat during a trip, the receipts for the rental of the tackle within the state are subject to use tax. 2/15/68.

330.2045 **Charter Vessel.** Time charters of oil tankers transporting oil from Alaska to California constitute contracts for transportation services and are not taxable as leases of tangible personal property. 6/7/71.

330.2078 **Chemical Toilets—Additional Service Charges.** A monthly portable rental charge includes servicing once a week. If the client requires servicing two or three times a week, an additional charge is also billed.

It is assumed that the tangible personal property at issue is chemical toilets, and that the ‘‘additional service charges’’ are separately stated from the rental payment. Any servicing of the leased toilets over and above that which is included with the lease is provided only at the request of the customers, and the charge is separately stated from the rental payment. The separately stated payments for an optional service charge are not included in the measure of tax. 7/19/91.

330.2079 **Chemical Toilets—Cleaning Services.** A statement on the lease agreement that ‘‘service is optional to the lessee’’ is sufficient to exclude cleaning services from the measure of lease receipts. The requirement that the lessee must ‘‘order sufficient service so as not to overtax the restroom’s designed capacity’’ does not make the service mandatory. The lessee is not required to obtain the service from the lessor. 12/18/92.

330.2079.010 **Chemical Toilets—Cleaning Service.** When there is no explicit agreement that cleaning services are provided at the option of the lessee, the lessor’s track record of never leasing units without contracting for cleaning services is strong evidence that the charge for cleaning is a mandatory service. 10/31/91.

330.2080 **Chemical Toilet Units.** Tax on the leasing of chemical toilet units is measured by the entire rental price provided that no service is given. If cleaning service is provided at the option of the lessee, a separately stated cleaning charge can be excluded from the measure of tax. Leases of these units to California state parks are subject to tax. 1/9/69.

330.2095 **Commencing Out-of-State.** Unless California sales or use tax has been paid upon the purchase price of the leased property, the possession of leased property in this state by a lessee is a continuing purchase for use of that property while in this state. If a lease involving an out-of-state lessor commences at an out-of-state location, the lease proceeds are subject to use tax when the property enters California. This applies unless the lessor exercised the option specified in Regulation 1660(c)(8), which is available only if the property was purchased for use in California. If the property was purchased for use in this state, and the lessor has paid a sales or use tax to another state and elects to measure the California liability by the purchase price rather than rental receipts, a credit may be allowed for the tax paid to the other state. If the property was used in a California county having a total tax rate equal to or less than the other state’s tax rate at the time of purchase, the election is deemed to be automatic and no tax is due on rental payments. 10/14/93.

330.2100 **Commingling of Ex-Tax and Tax-Paid Parts.** Taxable rental receipts from water softener units acquired ex-tax but repaired with tax-paid replacement parts remain taxable, subject to tax-paid purchase deductions for tax-paid replacement parts used. The commingling of ex-tax and tax-paid parts does not affect the tax status of the units. Even if all parts of the units are replaced by tax-paid parts over a period of time, rental receipts remain taxable, subject to the tax-paid purchase deductions. 3/13/70.

330.2101 **Communication Tower Sites.** A company owns a number of communication tower sites. The sites are made available for rental to telecommunication companies who pay a rental fee for the right to install their antennas on the towers.

The transaction is **not** a lease of tangible personal property, but a lease of an interest in real property (the towers). Therefore, tax does not apply. 5/23/95.

330.2102 **Community Property.** Property which was acquired tax-paid as community property and leased in substantially the same form as acquired by the community was awarded to the husband upon dissolution of the marriage. Rental receipts are not subject to tax when the husband continues to lease the property. The tax-paid status carries over to the husband's sole ownership. 5/28/71.

330.2102.750 **Computer Terminal with Analysis of Electrocardiograms.** A lessor rents computer terminals to physicians for use in their offices. The equipment is used to provide analysis of electrocardiograms (ECG's) performed in the physician's office. The terminal is described as a three channel, ten wire, twelve lead ECG instrument which connects directly to the patient to take readings on the twelve leads automatically. The patient's age, weight, and other data are entered via a keyboard and included on the printed report. The terminal is connected via telephone lines to the lessor's central computer. The terminal automatically dials the computer and transmits the collected ECG data. In seconds, the computer responds and the terminal prints a complete analysis of the ECG. In addition, a board-certified cardiologist is on call at the computer site to review and assist in interpreting the report. A physician can call the computer site and discuss the report with the specialist. The lessor charges a flat amount per month for the equipment. In addition, a separate charge is made for each time that the equipment is used to provide an ECG analysis. No charge is made for telephone consultations with the cardiologist.

The separately stated amounts charged for ECG analysis are service fees and, therefore, not subject to tax. Monthly charges for the equipment are lease receipts subject to tax unless leased in substantially the same form as acquired and tax has been paid at the time of acquisition. 1/17/83.

330.2103 **Computerized Dictation/Transcription Systems.** A taxpayer sells and leases computerized dictation/transcription systems. The heart of the system is a computer which the taxpayer purchases from an outside vendor and a proprietary software package added by the taxpayer to perform the transcription function. The computer and software are then sold or leased to the customer for a package price.

When the system is sold to the customer, the entire sale price would be subject to tax. When the system is leased to the customer, the lease receipts would be subject to tax if the system (in particular, the software components) is not leased in substantially the same form as it was acquired by the taxpayer. Since the software is proprietary software media, tapes, drums, discs, manuals, etc., it is assumed that the software is not leased in the same form as acquired. That is, the lessor generally would duplicate the proprietary software on blank storage media. 7/15/81.

330.2110 **Continuing Sale for Life of Lease.** When a lessor leases property in a continuing sale, the lease of that property by the lessor is always a continuing sale. Similarly, when a lessee leases property for sublease and gives the prime lessor a resale certificate, the lease to the lessee/sublessor remains a continuing sale for the life of the prime lease agreement. The lessee cannot revoke the resale certificate in midterm and convert the subsequent lease to a taxable status. In other words, the giving of a resale certificate fixes the character of the transaction for the period of the lease term between the prime lessor and its lessee. 1/15/82.

330.2112 **Conversion of Ex-Tax Leased Property to Tax Paid.** A lessor purchased equipment ex-tax and did not make a timely election to report tax based upon the purchase price. Since all of the lessor's other rental equipment is on a tax paid status, it would like to convert the item in question to a tax paid status, as well. The lessor proposes to accomplish this result by ''selling'' the property for fair market value to an unrelated ''liquidation company'' for immediate ''resale'' back at the same price. Tax would be paid by the ''liquidation company'' and the equipment could then be leased tax paid by lessor.

The incidence of taxation in a transfer of property depends on the substance of the transaction and is not controlled solely by the means employed to transfer title (*Commission* v. *Court Holding Co.,* 324 U.S. 331). Also, a taxpayer may carry out its business transactions in a fashion calculated to minimize the tax liability so long as the transfer has business substance and is not a mere sham (*U.S.* v. *Cumberland,* 338 U.S. 451).

Under lessor's proposal, there is no business substance. The sole purpose is to subvert the tax law and, therefore, it is recognized as a sham and should not be given any effect for sales and use tax purposes. 10/21/88.

330.2115 **Credits Against Rental Charges.** Although the lessee was responsible for the repairs on the leased equipment under the lease contract, both parties subsequently agreed to split 50–50 the cost of a major repair. They also agreed that the lessee would pay the repairer's bill and credit the lessor's share of the repair bill against each monthly rental charge until the lessor's charge was paid back to the lessee.

The agreed net form of payment for the repairs was only a procedural matter of convenience rather than a substantive waiver of monthly rental consideration. The rental consideration for the lease was still subject to use tax and thus the tax was collectible by the lessor from the lessee at the time of the credit allowance. 3/7/95.

330.2135 **Data Base.** A firm has a data base of title documents consisting of computerized indices, microfilm copies of recorded documents, and paper or microfilm copies of maps or other miscellaneous documents.

The firm plans to enter into contracts with customers under which (1) the customer would have access to the data base at a single physical location for five years, (2) the customer would make monthly payments based on usage, and (3) the customer would obtain title to copies of the data base at the end of five years by payment of an amount in excess of $100.

The charge for access to the data base is considered a lease. Assuming the data base is not in the same form as acquired, (e.g., paper or microfilm copies are made by the firm), the lease is subject to tax measured by the monthly payments.

If the customer exercises the option to purchase, the option price is taxable. 12/5/95.

330.2136 **Data Receiving Service.** A taxpayer provides each of its subscribers with data receiving equipment and also provides information to the subscribers by satellite transmissions which are received by the equipment. The receiver is not a computer and has no keyboard or data storage capabilities. The taxpayer retains ownership of the receiving equipment and the equipment is returned to the taxpayer upon cancellation of the subscription.

The taxpayer's basic package requires the subscriber to pay a one time start up fee and a monthly subscription fee. The subscriber can also obtain additional services (similar to the obtaining of a premium channel) on cable television. The billing method indicates that the equipment is being leased to the subscribers. The amount of the start up fee and the amount of the monthly fees depend upon the type of equipment furnished to the subscriber.

The subscribers receive two components: the data receiving equipment and the electronic satellite transmissions. The furnishing of the satellite transmissions does not involve the transfer of tangible personal property and the service of providing the transmissions are not regarded as services related to the sale of tangible personal property. The charge attributable to these services is not subject to tax. The billing method indicates that the equipment is being leased. The application of the tax to charges attributed to the lease is the same as the application of tax to leases generally. 10/16/91.

330.2137 **Date Lease Begins.** A lease provides that the lessee's rent begins on the date of installation. The vendor does not bill the lessor until the lessee and the lessor both accept the equipment. The billing by the vendor may be as long as 120 days after installation.

In order to avoid paying tax on rental receipts, the lessor must report tax on cost on the return for the period in which the property was first placed in rental service. In this case, this would be the period in which the property was installed. 5/18/89.

330.2140 **Default—Allocation of Security Deposit.** There is no provision in the Sales and Use Tax Law concerning the order in which funds from a security deposit must be applied upon default. If the lease contract itself does not specify an order, the lessor may apply the security deposit funds as it deems appropriate.

Thus, if the lessor applies any of the security deposit funds to satisfy charges which are taxable, the lessor is liable for payment of the tax. For example, if the lessor applies a portion of the security deposit to the past due lease payments, the amount applied is considered lease payments which are subject to the use tax. 1/3/96.

330.2150 **Design and Set Rentals for Video Productions.** A company is engaged in the business of designing and building sets for video productions which are used mostly in television commercials and music videos. Detailed drawing, rendering, and overlays are prepared to illustrate the proposed appearance of the set, ideas for camera positions and lighting effects. The walls, platforms and other components of the set are usually prefabricated at the company's shop from materials purchased ex-tax under resale certificates. The set components are then loaded on to the company's vehicles for transportation to the location of the shoot, unloaded and assembled together. The company then dresses the set by positioning props, cameras, and lighting. It also controls the art production crew and directs necessary changes in the positioning of cameras and props. When the shooting is completed, the set is disassembled with all usable materials being returned to the shop and the remaining materials discarded. Generally, the invoices simply bill a lump sum for ''cost of sets'', ''set construction'' or ''set construction: rental'' without listing the separate components. The company did not charge or report tax on the lump sum charges for set construction because it believed that it performed artistic design services and did not sell or lease tangible personal property.

Since the customers desire the property produced by the design services (the sets) and not the design services per se, the transactions are not services. Since the company transfers possession of the sets to its customers for a consideration, their transactions are leases. A lease is defined to include ''rental, hire and license,'' and, with certain exceptions not relevant here, leases are ''sales'' and ''purchases''. The design services are required to produce the property in the form desired by the customer and are, therefore, generally taxable as ''part of the sale'' of the property. In this case, the contracts show that the service of designing sets was offered to the customers together with the sets as a package. Therefore, the design services are ''part of the sale'' of the sets and are fully taxable, with the exception of installation labor. The remaining charges (i.e. transportation, disassembly labor, etc.), which were not separately stated, are also subject to tax. 4/23/91.

330.2154 **Disaster Preparedness.** Taxpayer A purchases a computer ex-tax by issuing a resale certificate. It leases the computer to taxpayer B, who in turn issues a resale certificate indicating it will sublease the equipment.

Taxpayer B is engaged in the business of disaster recovery, i. e., an unplanned interruption of the operations of, or inaccessibility to, the customer's computer facility. Customers are entitled to draw upon taxpayer B's computer inventory to continue operations.

Customers pay a monthly subscription fee for the ''disaster recovery service'' which involves a variety of services in addition to access to the computer inventory (e.g., disaster recovery planning, technical support, software systems, updates of plans).

Taxpayer B is not subleasing the equipment. It exercises dominion and control over it during all periods when the equipment is not being used by subscribers during disasters. Such use by the subscribers is extremely rare. Taxpayer B is liable for use tax on its lease payments to Taxpayer A. 1/14/88.

330.2156 **Diskettes Containing Database Information.** Company X produces floppy disks that contain ''database information'' supplied by Company Y. Company Y purchases these diskettes tax-paid and subsequently licenses them to customers in substantially the same form as acquired from Company X. The license agreement provides that Company Y owns all rights, title, and interest in the database information

contained on the diskettes. The agreement further provides that the diskette must be returned to Company Y if the customer chooses not to renew the license agreement. The license agreement does not provide the customer with an option to purchase the diskette.

Based on these facts and assuming the transfer of the diskettes by Company Y to its customers is for a fixed term, the transaction is a lease of the diskettes to its customer by Company Y in substantially the same form as acquired pursuant to Regulation 1660(c)(2), and no use tax is due with respect to the rentals Company Y charges its customers. 2/23/95. (Am. 2003–1).

330.2158 **Donated Property.** Costumes are donated to a lessor who alters them before renting. Sales tax reimbursement is paid on materials used to alter the costumes.

The lessor did not pay tax on the purchase price of the donated costumes since they were donated to the lessor. Therefore, the lessor is obligated to collect use tax on the rentals payable on these donated costumes. 6/10/94.

330.2160 **Driving Range—Use of.** A charge for the use of a golf driving range is not a rental to which tax applies even though the charge is based upon the number of golf balls used. 11/29/65.

330.2165 **Early Termination.** A firm contracts to lease 500 container chassis over a period of time. The contract contains an early termination clause and a purchase option clause. In order to terminate the contract early, the lessee is required to make a payment ‘‘as to all, but not less than all, of the equipment’’ and to return the equipment to the lessor. In order to exercise the purchase option, the lessee may purchase ‘‘all, but not less than all’’ the equipment at annually decreasing option prices over an 18 year period. If the lessee does not take advantage of the purchase option prior to the end of the lease term, the lessee is required to purchase all of the equipment then remaining subject to the lease for $1.00 per unit. Since the amount required to be paid to terminate the contract early is substantially less than the purchase option price, the early termination clause is considered to be bona fide. Therefore, the lease contract is not for a fixed term with title passing to the lessee upon completion of the required payments or by opting to purchase the equipment for a nominal amount, i.e., a sale under a security agreement from its inception. It is a true lease and not a conditional sales contract. 8/9/89. (Am. 2002–2).

330.2170 **Election—Payment of Tax Measured by Rentals Payable Under Prime Lease or Sublease.** The determination of whether tax is due measured by rentals payable under a prime lease or by rentals payable under a sublease is similar to the determination of whether tax is due measured by purchase price or by rentals payable under a prime lease.

A lessor who has elected to pay tax measured by purchase price may not change methods after the lease has commenced and obtain a refund in order to collect tax on rentals payable. Similarly, a lessee who has been paying tax measured by rentals payable under the prime lease may not change methods and treat the lease as for resale in order to collect tax measured by rentals payable under a sublease. That is, once the prime lease has commenced and taxes are paid measured by rentals payable, the sublease is not a sale. The lessee may not change methods and issue the lessor a resale certificate. Thus, a refund is not allowable on this basis (i.e., tax-paid purchases resold). On the other hand, had the lessee issued the lessor a timely resale certificate, the lessor could properly lease the property tax free and taxes would be due on rentals payable under the sublease. (See Annotation 330.2880.) 4/13/90.

330.2176 **Election to Report on Cost.** Under Regulation 1660, when a person pays sales tax reimbursement to his vendor and leases that property in substantially the same form as acquired, he has made an irrevocable election to treat the lease as a nonsale. Accordingly, he cannot later, either by taking a tax paid purchase resold deduction or having the seller file a claim for refund, convert a nonsale to a sale. This is so notwithstanding the fact that he has collected use tax measured by rental receipts from the beginning of the lease period. 5/26/71.

330.2179 **Election to Report on Cost.** For property leased in substantially the same form as acquired, payment of tax measured by the purchase price at the time the property is acquired constitutes an

irrevocable election not to pay tax measured by the rental receipts. The lessor may not change his election by reporting tax on rental receipts on his return for the period the property is first placed in rental and claiming a tax paid purchases resold deduction. 5/13/69; 5/20/96.

330.2200 **Equipment Leases.** When a sublessor of property with an existing sublease obtains title to the subleased property, the sublessor, now the lessor, cannot alter the manner of reporting. If tax was being collected, and reported, measured by rentals payable, then the sublessor, now lessor, must continue to collect and report tax on that basis. 5/12/92.

330.2215 **Equipment and Software Furnished with Database Access.** A firm enters into a contract with a customer to furnish information obtained from the Department of Motor Vehicle's (DMV) database. It furnishes the necessary hardware and software at the customer's location and also provides software updates and telephone support. Access to the database is through the firm's computers to ensure that DMV's security requirements are met.

The firm charges the client based on:

(1) one time start-up fee

(2) a ''per transaction fee''

(3) a ''per minute connect fee''

(4) a monthly support fee (training, equipment, support services)

(5) communication software

(6) a monthly equipment maintenance fee

The firm is a lessor of equipment, software, and updates. It is not the consumer of these items in connection with providing a service. The customer wants the ability to perform its own DMV inquiries. The firm fulfills this need by providing the necessary equipment and software. There is a temporary transfer of possession of property to, and use of the property by, another for consideration. This is a ''lease'' as defined in section 6006.3.

Since the hardware was acquired tax paid and leased in substantially the same form as acquired, tax does not apply to charges related to the lease of the hardware. The software is not leased in substantially the same form as acquired and, thus, the charges related to the lease of the software are subject to tax. The charges for software updates transferred in tangible form also are subject to tax. The telephone support also is taxable unless optional and separately stated. 10/28/96.

330.2223 **Erection and Maintenance of Temporary Ice Rink.** A taxpayer contracts to provide and install two ice skating surfaces to be used in the taping of a television special. The contract specifies that installation of the surfaces begin on July 6, with taping scheduled for July 10 and July 11, followed by dismantling of the rink on July 12. The contract specifies that the taxpayer is to provide two ice skating surfaces and related support equipment such as header-boards, hoses (up to 1003) and refrigeration containers, dasher rails consisting of 4402 of steel frame with lexan covers, and tenting material to cover the ice skating surfaces during the daylight hours. The contract further specifies that the taxpayer is to provide supervision of the installation, maintenance, resurfacing, and removal of the ice rink and transportation of ice equipment and trained personnel to and from the rink site. The contractual obligations of the client are to provide generators to power the refrigeration equipment, water for ice machines, devices such as wheelbarrows for disposal of the ice, liability insurance naming the taxpayer as the insured, labor to assist in setting up and breaking down the ice rink, security, parking and site access for the taxpayer's engineers, and accommodations for the ice engineers and project managers.

The contract is for the lease of ice rinks rather than for providing of a service. Tax applies in accordance with Regulation 1660. 11/22/96.

330.2244 **Extensions of Lease Periods.** Under a lease of tangible personal property the lessee has the option at the end of the lease of surrendering the property, purchasing the property for 10% of the purchase price, or continuing to lease it. Originally, the lessor purchased the property in California tax paid and leased it in the form in which it was acquired. Since the leases are not sales at inception or continuing sales, no tax applies to rental payments under an extension of the lease, provided that the extension of the lease does not result in the lessee acquiring title at the end of the extension or purchasing the property at the end of the extension for a nominal price. (Regulation 1660(a)(2)(A).) If the lessee exercises his option to purchase, the sale is subject to tax. 11/10/94.

330.2250 **Factory Built School Buildings.** The purchaser of a factory-built school building who leases it to a school district and installs it on realty at a site furnished by the lessee is the consumer of the building and sales or use tax applies to 40% of the price paid to the seller of the building. The price subject to tax does not include any amount for placing the completed building on the site.

The lease of the building is a lease of real property and tax does not apply to the rental receipts. 9/2/92.

330.2260 **Film for Textbook Production.** The lease of film negatives or positives for textbook production is subject to tax. The measure of the tax is the royalty payment. 12/12/69.

330.2265 **Fixed Price Lease Contracts.** A lease contract with fixed lease payments along with a mandatory maintenance contract which allows for periodic increases for the maintenance contract; is not a fixed price contract because the costs of the lease are not fixed from the outset. 8/3/92.

330.2270 **Gaseous Oxygen Storage Tanks.** A hospital has two storage tanks for gaseous oxygen that are part of a storage unit set in place, with a back-up storage unit for emergencies. The gas storage tanks are referred to as ‘‘vessels’’ to distinguish them from the portable gas ‘‘cylinders’’. The hospital questions its supplier collecting tax measured by the rental payments.

The application of tax to leases of vessels is different than the application of tax to leases of cylinders. Large items such as vessels are considered to be fixtures. In this case, the supplier is leasing fixtures and has elected to pay use tax measured by the rental payment. Thus, the supplier (lessor) must collect tax at the time the hospital makes the rental payments. This opinion applies only to the taxation of the leases of the vessels. It does not apply to charges for the gaseous oxygen itself. 4/8/91; 5/3/91.

330.2280 **Guard Dogs.** The placement of guard dogs, trained to attack anyone but their handler, on a client’s fenced property after the client’s departure at night and their removal prior to his arrival in the morning is not a rental of the dogs making the owner-taxpayer’s receipts subject to tax, because it is questionable whether ‘‘possession’’ is transferred and the dogs are clearly not under the client’s direction and control. 5/19/69.

330.2283 **Horses.** A taxpayer rents horses which it acquired ex-tax through ‘‘occasional sales.’’ The taxpayer has three types of arrangements: pack trips, all day rentals, and hourly rentals. The receipts from pack trip ‘‘rentals’’ are not taxable. Under these circumstances, there actually is no lease because the horses remain under the control of the taxpayer. The receipts for hourly rental are not taxable if the charge is less than $20 and the use of the horse is limited to the taxpayer’s premises. The receipts from all day rentals are taxable even if the horse is used only on the taxpayer’s premises if the charge exceeds $20. 1/8/75.

330.2285 **Indenture Trustee.** An owner/lessor forms a trust and selects a bank to act as trustee. The trust purchases the equipment and leases it to a lessee. Under these circumstances, the trustee (bank) is responsible for collecting and reporting tax on behalf of the trust.

In cases in which rents are collected by a bank as an indenture trustee, the owner/lessor of the property is responsible for collection and reporting of the tax. Under these circumstances, the indenture trustee merely

holds a security interest on behalf of the lenders. The owner/lessor in this case merely has assigned the collection responsibility as contrasted to the situation in which a trust is created for the purpose of holding ownership and collecting rents. 3/15/89.

330.2286 **IRS and FTB Definition of a True Lease.** The revenue procedures and rulings of the Internal Revenue Service and the Franchise Tax Board do not control the application of the California Sales and Use Tax Law. Thus, the IRS and FTB definition of a ''true lease'' have no authority and are irrelevant as to sales and use tax issues. The IRS and FTB positions do not control whether a transaction is subject to sales and use tax. 4/30/98. (M99–1).

330.2287 **Lease of an Illustration.** A contractor prepares an illustration which is transferred to a magazine publisher for a one-time right to use it in the magazine. This temporary transfer is a lease of tangible personal property, and the contractor, as the lessor, is responsible for collecting use tax from the publisher, and the reporting and payment of the tax to the Board. 10/14/93.

330.2288 **Illustrator for Publications.** An illustrator delivers to a magazine company the temporary possession of an illustration for use in a publication. Upon publication the original illustration is returned and the illustrator is paid. The transaction is a lease of the property which is subject to use tax. The tax must be reported and paid by the illustrator-lessor for the period in which payment is received.

If all rights to the illustration are relinquished at the time of the transfer and the illustration is not returned to the illustrator, the transaction is a sale and sales tax is due for the period in which the illustration was delivered to the magazine company. 10/5/93.

330.2289 **Incidence of Tax in a Series of Leases.** Where tangible personal property is leased and subleased to numerous lessors with no use of the property except by the final sublessee and no sales tax has been paid anywhere, the ''definite point'' at which tax applies is the end of the chain, i.e., the sublease to the final sublessee. Since no tax had been paid on any of the leases or the original purchase, all leases prior to the lease to a consumer are leases (sales) for resale, whether or not a resale certificate is given. If uncollectible from the last sublessor, one can look only to the consumer/lessee for the tax. 9/16/85.

330.2290 **Intent of Purchaser.** Taxpayer purchased tangible personal property in another state. Tax was paid with respect to the purchase in the state in which the purchase was made. Taxpayer leased the equipment to customers in the other state for a substantial period of time. Upon termination of the lease the taxpayer transported the property to California with the intention of placing the property in lease service here. The property was brought into this state more than 90 days after the date of purchase. The property was then placed in rental service in this state.

The leasing of the property is a ''sale'' by taxpayer and a ''purchase'' by taxpayer's lessee and is taxable. Taxpayer has no election to pay use tax measured by the purchase price of the property since the property was not purchased for use in this state.

Where the property is in rental service outside this state for more than 90 days before it is brought here, it will be regarded as having been purchased for use in this state only if it can be specifically established that at the time the property was purchased the purchasers intended to utilize it in this state. If, for example, a taxpayer purchased certain equipment to be utilized in the performance of a contract to be performed in this state, but the equipment was first utilized outside this state due to a delay in the commencement of the California contract, then the taxpayer could pay tax measured by the sales price to him of the equipment even though the equipment might have been utilized for more than 90 days in another state. The tax would have to be paid with the return for the period during which the equipment was first placed in rental service in this state. The taxpayer could then take any credit allowed by Revenue and Taxation Code section 6406. 4/28/75; 11/26/71.

330.2297 **Lease Agreement Statement—''Rental Not Taxable.''** A lease agreement between the lessor and the lessee includes this statement:

‘‘. . . if ‘Rental Not Taxable’ has been checked on the face of this agreement, lessor warrants that lessor has paid sales tax pursuant to section 6052 of the California Revenue Taxation Code or has paid use tax measured by the purchase price of the equipment and that the equipment is in substantially the same form as acquired. Lessor will indemnify contractor against any sales or use taxes that may be claimed to be due in connection with this lease or the rentals or other payments hereunder.’’

In this example, the lessor is merely complying with the requirements imposed by Regulation 1686(b) that the lessor notify the lessee when lease or rental transactions are not subject to use tax and the facts supporting the lessor’s rationale for not collecting the use tax from the lessee. The language employed in the lease agreement in fulfillment of this requirement is only a statement by the lessor that tax was paid on cost and a promise to indemnify the lessee if this statement is false. The statement does not act as an exemption certificate. In the event that use tax was not paid on cost, the lessee is liable for payment of the use tax, however the lessee may have recourse against the lessor. 7/16/81; 12/4/01. (Am. 2002–3).

330.2299.125 **Lease of Convention Exhibit Component Systems.** A California lessor leases an exhibit to a California company for a show in Dallas, Texas. The lessor ships the exhibits by common carrier F.O.B. the loading dock in California, and the rental amount is paid in full before the lessee receives possession. After receipt of the exhibit, the lessee ships it to Texas for use for the entire term of the lease, after which it is returned to California for storage.

No tax will apply to lease payments attributable to use of the property outside of California. If the property is used in California during any portion of the lease term, the lease payments should be prorated between in-state use and out-of-state use. However, if the property is not functionally used in California, then all of the lease payments are nontaxable. The retailer may overcome the presumption contained in section 6247 by obtaining a written statement from the purchaser that the property was purchased for use out of state. This statement, taken in good faith, will relieve the retailer, but has no effect on any liability of the purchaser. 5/24/93.

330.2300 **Lease of Equipment Acquired Ex-Tax.** The lease of equipment, acquired ex-tax, as a part of a partnership dissolution, is regarded as a continuing sale. Thus, the lease of the equipment is subject to use tax measured by the rentals payable, which the lessor must collect and pay to the state. 5/8/90.

330.2302 **Lease of Equipment with Optional Operator.** A lessor proposes to operate an on-site copy, fax and mail center on the premises of its customer as follows. The lessor will purchase and pay tax or tax reimbursement on the purchase of copiers, fax machines, and mailing meters and will lease this equipment to the customer in the same form as acquired. The lessor will provide all of the supplies used by the equipment. At its option, the customer may supply the personnel to operate the equipment or may contract with the lessor to supply the personnel to operate the equipment. If the lessor’s personnel operate the equipment, the lessor will provide a full-time manager and personnel to operate the equipment leased. The lessor will select, hire, and train the personnel it provides.

The customer may also at its option choose to maintain the equipment itself or choose to pay extra for maintenance. The contract provides for a ‘‘monthly management fee’’ and a ‘‘monthly fee for allowance.’’ The ‘‘monthly management fee’’ is to provide management reports and counseling to the customer. The monthly fees for allowance cover a stated number of copies, all rental charges for the equipment, all charges for supplies, and all charges for the lessor-supplied equipment operators, within the stated number of copies per month allowance. For additional copies beyond the monthly allowance, there is a charge per copy which includes the cost of supplies. There is also an hourly rate charge for an additional operator, if needed, due to workload. The contract further provides that if the workload is beyond the capabilities of either machine or normal working hours, the customer may elect either to send the overflow copying work to the lessor’s off-site main plant at a per copy charge or to have the lessor’s personnel work overtime on-site at a specified overtime rate.

In the above situation the question is whether the contract is (1) a contract for the sales of copies by the lessor to the customer or (2) a contract of which the three primary components are the lease of equipment

which the customer will use to make copies, the providing of personnel by the lessor, and the sale of supplies.

If the contract is deemed a sale of copies by the lessor to the customer, all amounts paid under the contract are taxable gross receipts from the sale of tangible personal property with no deduction for the cost of the materials used, the labor or service cost, or any other expense with an optional operation provision.

There is not a true lease if it is mandatory that the operator comes with the equipment. This is because there cannot be a true lease unless possession and control of property has been transferred from one person to another. If a person obtains for consideration temporary possession and control of property without an operator, the person has leased the property. However, when a person obtains property with an operator, the question arises whether possession and control actually has been transferred to that person. The test that is used to decide the question is whether the person could have obtained the property under the contract without the operator. If so, we regard the transaction as a lease with an optional operator. In effect, since the operator is optional, the operator is acting on behalf of the lessee. Thus, when the operator is optional, there is a lease of property along with services of the operator. When the operator is mandatory, the operator acts on behalf of the owner and that owner is not regarded as transferring control of the equipment to the customer. Since there is no transfer of possession and control, there is no true lease.

Since this contract provides for an optional operator, the lease is a true lease. Since tax on the equipment is paid by the lessor at time of purchase with the equipment then leased in substantially the same form as acquired, the rentals payable from the lease are not taxable. Likewise, charges attributable to the optional equipment operators are not taxable rentals payable but may be taxable under Regulation 1528(a)(1) because the operators of the copy machines may be performing fabrication of tangible personal property. If so, charges by the lessor for its employee's fabrication labor are taxable as a sale, unless the transaction falls within what is known as the loaned employee rule.

Since the lessor sells the supplies to the customer, it is important to determine whether the lessor or the customer performs the fabrication. Fabrication by oneself is not a taxable sale. In this situation, whether the fabrication is performed by the lessor or the customer is determined by applying the loaned employee rule which recognizes that one company may ''loan'' employees to another. In essence, the loaned employee is treated as an employee of the ''borrower'' company. In order to qualify for treatment as a loaned employee, the loaned employee must be an employee of the ''lender,'' the borrower/customer must provide the tools or equipment used, the raw materials and the premises at which the work is done, and the charge must be an hourly rate. In addition, the customer must have other persons who clearly are employees performing similar work or the customer must employ persons who are capable of giving meaningful direction to the loaned employees beyond describing only the result desired. Also, the customer, not the lender, must supervise the loaned employees.

The employees furnished under the above contract do not qualify as loaned employees since an hourly rate is not specified and charges attributable to fabrication labor are taxable. Similarly, the overtime charges also do not meet the hourly requirements of the loaned employee rule. Although specified at an hourly rate, these charges are not solely for the services of the personnel, but rather cover all the cost of copying and duplicating, machine operators, maintenance and repair.

The portion of the contract charges attributable to the labor provided by the lessor's personnel who operate the facsimile and mail meter machines and who make deliveries is not taxable because the charges are for nontaxable services, as are any added charges for optional maintenance services.

The ''monthly management fee'' is part of an integrated contract for the lease of equipment, the sale of supplies, fabrication labor and services. Some of the components of this contract are taxable such as sales of supplies and fabrication. Therefore, the portion of the ''monthly management fee'' attributable to the taxable components are subject to tax. 4/8/94.

330.2305 **Lease and Lease Back.** A company owns tax paid equipment that it will lease to a financing organization for a period of 15 to 20 years. The financing organization will pay the company a lump sum

which will equal the lease payment stream otherwise payable over the term of the lease, discounted at an appropriate rate. The company will retain title to the equipment throughout the lease period. The financing organization will sublease all equipment to the company for a period of 7 to 12 years. At the end of the sublease and at two other times during the sublease, the company will have the option to ‘‘buyout’’ the financing organizations remaining interest in the lease.

Since the company never passes title to the equipment to the financing organization and the company will retain title to the equipment at the end of the contract term, the transaction is a lease from the company to the financing organization. Based on the statement that the equipment is leased in substantially the same form as acquired and that California sales tax or use tax was paid with respect to the company's purchase of the equipment to be leased, the lease of the equipment by the company is not a continuing sale and is not subject to use tax. Assuming the company timely paid tax on the purchase price, the sublease as well as the prime lease are regarded as tax paid. Thus, the sublease also is not a continuing sale and is not subject to use tax. 7/9/92.

330.2305.180 **Lease of Medical Equipment.** A corporation is engaged in selling and leasing medical equipment and related supplies. Under one type of arrangement, the corporation furnishes hospitals with a medical instrument at no cost. The hospital must in return agree to place a standing purchase order for one box of catheters per month per instrument for use with the instrument. The price charged for the catheters under this agreement is higher than the list price. The hospital has the option of applying 50% of the amount over the list price charged for the catheters toward the purchase price of the instrument. The hospital also must pay a penalty of $475 if the instruments are returned in less than six months.

Since the amount charged for catheters under this type of agreement exceeds the regular price, the difference is regarded as a charge for rental of the instrument. Since tax was paid with respect to the entire charge, no further tax is due. 9/4/85.

330.2305.200 **Lease of Medical Records.** As a preliminary step to the execution of a management agreement, a medical group sold all of its medical equipment and records to a health services company who in turn leased it all to the management firm, a related company. The equipment and the medical records remained in the possession of the medical group. Although separate lease payments were made for the equipment and the medical records, the latter amount was not reported on the health services company's sales tax report.

Although medical records may be valued for their intellectual content, they are clearly tangible items that may be seen, measured and weighed. Since the medical records themselves are useful to the physicians, their value is not limited to their intellectual content and the lease receipts are subject to tax pursuant to Regulation 1660. 7/29/92.

330.2305.775 **Lease of Photograph.** A person who is in the business of providing photos of a variety of subjects sells the right to publish the photo. The sale of such rights is a ‘‘lease’’ for sale and use tax purposes. If the property furnished is a print on which tax has been paid to the film processing lab, the lease of the print is not subject to tax as the property is leased in substantially the same form as acquired and tax has been paid. However, if the property furnished is a transparency, tax applies to the lease since it is not leased in substantially the same form as acquired. 2/26/86.

330.2305.900 **Lease Proceeds.** The amount shown on the lessor's worksheet as ‘‘mandatory purchase price’’ is regarded as additional gross receipts because the specific language on the worksheet (assumed to agree with contract language) denotes the amount to be an option price, as opposed to an interest or finance charge notwithstanding that the economic substance of the charge may appear to be in the nature of such a charge. This principle applies to both leases that are sales at the inception and true leases on which the lessor timely elected to report tax on cost.

If the contract and the worksheet explicitly provide that the amount is a deferred interest charge, it may represent a deferral of the portion of the yield rate. However, without such contractual provisions, the only conclusion that can be reached is that the charge represents an option price. 1/19/84; 7/10/96.

330.2305.990 **Lease of Property Repurchased.** A firm sells backdrops which are used for television and films. On occasion, it repurchases the backdrop and places it in rental inventory. Since it will be leasing the backdrop in substantially the same form as acquired in the repurchase, the firm has the option to timely pay tax on the cost of the repurchase and the rental will not be subject to tax. If it does not timely report tax on cost, the rental receipts are subject to tax. 5/27/97.

330.2306 **Lease of Property to a Museum.** The exhibition by a museum of an animated dinosaur exhibit belonging to others, with a fee paid by the museum to the owner for the licensing rights, was not a lease because the museum did not acquire sufficient dominion or control over the properties. Under the licensing agreement the museum agrees: to operate the exhibit on museum premises only; not to move the exhibits without prior written authorization from the owner; to operate the exhibit only during normal exhibit hours; to display the exhibit in a temperature controlled enclosed building . . . ;not to allow photos or videos to be taken for commercial purposes . . . ;not to duplicate any of the components of the exhibit. Under these conditions the license was not a lease, the owner was the consumer of the animated dinosaur exhibit, and did not require a seller's permit. 3/11/94.

330.2307 **Lease of Racing Qualities of Horse.** A person, who owns 50 percent of a horse, ''leases'' the horse's racing qualities to the other owner of the horse. The rent is to equal 50 percent of all purses won by the horse, less 50 percent of the expenses. The ''lessee'' is to have control over the racing performance of the horse, and has the right to have the horse raced under its name and color.

In this case there is no ''lease,'' ''sale'' or ''purchase'' because there is no consideration paid for the ''lease''. The ''lessor'' was 50 percent owner before the ''lease'' was entered into and already had the right to 50 percent of all income earned by the horse plus the responsibility for 50 percent of all expenses. 3/18/92.

330.2307.725 **Lease vs. Services.** The chief characteristic of a renting or leasing is the giving up of possession to the hirer, so that the hirer and not the owner uses and controls the rental property. 8/5/93.

330.2307.800 **Lease of Scale—Model Truck.** A handmade ¾ scale working model of Peterbilt truck-tractor is leased exclusively to businesses for promotional and advertising purposes. As it is never used for hauling persons or property for substantial distances, it is not within the definition of ''mobile transportation equipment,'' and the taxability of the leases is determined by Regulation 1660 rather than Regulation 1661. 5/7/86.

330.2308 **Lease of Sign Affixed to Realty.** A sign leased by the manufacturer that is attached to a building wall or roof, is a fixture. As such, tax applies to the rental receipts pursuant to section 6016.3, if the lessor has the right to remove the sign upon breach or termination of the lease, unless the sign lessor is also the lessor of the realty to which the sign is attached.

On the other hand, a sign firmly attached to realty, such as, a pole sign embedded in concrete in the ground, will be treated as a lease of real property. In this case, tax would apply to the contract to construct the structure (sign and pole) in accordance with Regulation 1521. As such, tax would apply to the cost of materials used to fabricate the sign itself, in addition to the cost of materials used to erect the sign pole. 7/2/93.

330.2310 **Lease Payments by Insurance Companies.** Insurance companies that pay lessors for medical equipment leased by a covered patient are not lessees of the property. The lease contract is with the patient and the applicable tax is a use tax imposed on the patient/lessee. If an insurance company is a lessee, the applicable tax is the sales tax since the use tax can not be imposed on an insurance company. 12/18/92.

330.2310.050 **Lease of Software.** Software is transferred by telecommunication from disk media owned by the transferor to tape media owned by the transferee, with the transferor retaining ownership and possession of the disk except that by contractual agreement the disk was placed in escrow for five years. The transferee is allowed access to the disk upon request for the purpose of verifying the accuracy of the software. Also,

by the same agreement, the transferor agrees to not remove the disk from escrow, use or make copies of the disk, or permit any other person to have access to the disk.

The agreement has the characteristics of a lease because the transferee has effective possession, use and control of the disk during the five year period. The transferee is liable for use tax on the payment for the transfer and the tax must be collected by the transferor and remitted to the Board. 8/1/86.

330.2310.075 **Lease of a Steam Generating Plant.** The sale of a steam generating plant which is a building or structure of a fixed work under Regulation 1521, when severance is not contemplated, is a sale of an interest in realty even though the land is not sold. Following the sale, the facility is leased. The facility does not lose its character as an improvement to realty under the lease contract. It is true that the facility incorporates within it items which would be classified as ''fixtures'' under Regulation 1521. Regulation 1596(c) applies to transfers of fixtures, but the lease contract involves the lease of a building, not merely the sale or lease of fixtures. Under Regulation 1660(d)(7), leased fixtures are classified as ''tangible personal property'' unless the lessor of the fixtures is also the lessor of the realty. Here the realty is the structure, and the fixtures in question are attached to the realty. Under these circumstances, the lease is a lease of realty, not tangible personal property, and tax does not apply. 12/8/89.

330.2310.100 **Lease of Used Modular Office Buildings.** Taxpayer purchases and refurbishes used modular office buildings, and then subsequently leases the buildings. The used office buildings are leased as tangible personal property; that is, in connection with the lease of the buildings, the taxpayer does not install the buildings on its customer's property. The taxpayer has paid sales tax on purchases of materials such as sheetrock and ceiling tiles which are used to refurbish the used modular office buildings. The taxpayer did not pay tax reimbursement nor report use tax on the purchase price of the used buildings.

Under these circumstances, the taxpayer is leasing tangible personal property in transactions which are continuing sales and purchases, subject to use tax measured by rentals payable. Therefore, materials purchased the purposes of incorporating it into the modular office buildings to be leased may be purchased ex-tax for resale. Accordingly, the taxpayer may take a tax-paid purchase resold deduction for any sales tax paid on purchases of materials which became a component part of the modular office buildings. The deduction must be taken on the return in which the taxpayer's lease of the building is included in its return. If the deduction is not taken in the proper quarter, a claim for refund must be filed. 3/25/97.

330.2310.115 **Lease of Vehicles to U.S. Government Contractor.** A taxpayer leases operating vehicles. In some instances, a vehicle is used for the sole purpose of transporting navy compressors and the cost is passed directly to the government. In other instances, a vehicle is used for various activities not related to a specific government contract, the cost is expensed out to an overhead account and not charged directly to the U.S. Government.

Both categories are leases which are subject to tax. In both instances, the lessee is the taxpayer. There is no sublease of the vehicle to the United States in either case. It is immaterial that the vehicles are used solely for the purpose of transporting navy compressors under a government contract and the cost is passed on directly to the U.S. Government.

While tax does not apply to leases of tangible personal property to the United States, there is no lease of property to the U.S. when the government contractor itself operates the equipment under a government contract. 5/13/91.

330.2310.118 **Lease/Sale—Repossession and Subsequent Sale.** A firm ''leases'' equipment to a restaurant owner under terms which provide that ownership transfers to the lessee for $1.00 at the termination of the lease. The restaurant owner defaults on the lease, and the firm enters into a contract with the former owner of the restaurant to ''assume the lease.'' The second contract contained the same provisions with respect to the transfer of ownership at the termination of the lease for $1.00 with a price adjustment due to the prior use of the equipment.

The original contract is a sale, and tax applies on the full contract price in the period in which the contract sale took place. The subsequent reacquisition by the seller because of default may result in bad debt deduction in accordance with Regulation 1642. The subsequent contract is also a sale at inception, and tax applies to the full contract price as provided in Regulation 1641. 4/16/97.

330.2310.200 **Leased Equipment Held for Resale by Lessee.** Taxpayer manufactures and sells specialized equipment. The taxpayer sold a piece of this equipment to a Financial Institution (FI) and leased it back. The lease agreement was for 36 months with an option to purchase the equipment for $251, consisting of an ''option price'' of $1 and a ''termination fee'' of $250. The purchase price exceeds the limits for a purchase option to be considered ''nominal'' under Regulation 1660 and therefore the contract is a true lease. The FI did not issue a resale certificate nor was sales tax paid at the time of the sale to the FI. The FI billed the taxpayer use tax on the monthly lease amount, but the taxpayer refused to pay the use tax contending that the equipment is held for resale and is used specifically for nontaxable demonstration purposes.

Under these specific facts, the taxpayer has used this method for financing what amounts to a part of its resale inventory. Whether the contract between the taxpayer and the FI is a lease or not, under these specific facts, the taxpayer is holding the equipment for resale. Thus, no tax applies until the taxpayer sells the equipment. The taxpayer may properly issue a resale certificate to the financing company for the equipment. 12/29/95.

330.2311 **Leases of Returnable Containers.** A lease of tangible personal property is regarded as one sale for the term of the lease. Where a lease is renewed, or if another lease is entered into, these leases are regarded as separate sales.

Thus, when a lease is of new returnable containers on which the rental receipts are subject to tax, the subsequent renewal of such a lease is a sale of returnable containers resold for refilling and therefore exempt from tax pursuant to Regulation 1589(b)(1)(B). For the lease of new returnable containers, tax applies to the total lease payments received under the terms of the lease and not only to that portion of the lease receipts which relate to the first filling of the new container.

When short term leases are renewed for new leases for longer periods, the tax application on the renewal would depend upon the circumstances surrounding the execution of the lease and the business reasons therefor. A resultant tax liability would depend upon the facts in each case. Thus, if a lessor entered into lease contracts of new returnable containers leased in a different form than acquired for three month periods and then renewed or re-leased the containers to the same parties for five-year periods, these transactions would be considered to be shams and tax would be asserted on the rental receipts received during all or substantially all of both periods. On the other hand, if the lessor entered into lease contracts of the new returnable containers for five-year periods, and then renewed or re-leased the containers, tax would be asserted on the rental receipts received during the initial period only. 3/28/69.

330.2311.250 **Leases of Signs.** A lease of a sign, which is a fixture, by a manufacturer of the sign is a lease of tangible personal property subject to tax on rental receipts when the manufacturer has the right of removal upon breach or termination and it is not the lessor of the realty. 10/24/96.

330.2311.900 **Lease of Vehicle.** An employer plans to purchase a vehicle from an automobile dealer and furnish it to one of its employees as part of an overall compensation package. Under the plan, the employee would pay the employer a monthly ''lease'' fee and would not receive title to the vehicle at the end of the ''lease'' term. Since the furnishing of the vehicle is part of a benefit package, there is no way to identify the true rental price and this type of transaction is not regarded as a market transaction. Thus, for sales and use tax purposes, the employer is regarded as the consumer of the vehicle and cannot purchase the vehicle for resale. 7/26/99. (2000–1).

330.2312 **Lease vs. Financing Arrangement.** A manufacturer leases the equipment it builds to end users. It then assigns the lease and simultaneously sells the equipment to an assignee, under a Purchase and Remarketing Agreement. The agreement provides that the manufacturer is the exclusive agent of the

assignee with respect to the lease of the equipment, subject only to the assignee's approval of credit. The manufacturer also collects the rental receipts including the use tax from the lessee. After the assignee has received 160% of the purchase price of the equipment, the manufacturer is entitled to share equally in the remaining lease receipts.

The Purchase and Remarketing Agreement transfers all rights, title and interest in the leased equipment, which must be identified as the assignee's. The manufacturer does not retain any rights in the equipment, but rather is paid a certain amount by the assignee for remarketing and administrative duties. The sharing of the income in excess of 160% of cost, does not indicate that the manufacturer retains any right or title in the equipment. Therefore, the assignee has assumed the position of lessor within the provisions of Regulation 1660(c)(9)(D) and is required to collect, report and pay the (use) tax to the Board. 3/11/82.

330.2313 **Lease of Vehicle—Formerly Owned by Wife of Lessee.** A leasing company purchased a vehicle from one person and then leased the vehicle to that person's husband. If the wife had sold the vehicle directly to the husband, the sale would have been exempt from sales and use tax. However, the sale of the vehicle from the wife to the leasing company is not exempt from sales or use tax under section 6285. Similarly, the lease from the leasing company to the husband is not exempt from sales or use tax under section 6285. If a timely election to report use tax measured by the purchase price was not made, the rental receipts from the lease of the vehicle are subject to use tax and the leasing company must collect use tax from the lessee measured by the rentals receipts. 11/7/90.

330.2314 **Leasing of Motion Picture Video Cassette Tapes to Airlines.** A motion picture studio distributes specially edited versions of its motion pictures to airlines for showing as passenger entertainment. These pictures are distributed on movie video cassettes which are made by an out-of-state laboratory. The cassettes are distributed to the airlines through two independent booking companies located in California. The airlines pick up the cassettes at the booking companies in California and return them at the end of the lease. The cassettes are shown only about 25 times because they become too ''grainy'' to be shown on large screens. The tapes are returned to the motion picture studio which destroys all the returned cassettes.

The motion picture studio is leasing the cassettes to the independent booking companies who in turn are leasing them to the airlines. Thus, the motion picture studio has exercised a right or power over the cassettes in California by leasing them and also destroying them at the expiration of the lease. The section 6009.1 exclusion does not apply because the cassettes were returned to California for destruction (and also returned to California between flights while in possession of the airlines). Accordingly, the motion picture studio both stored and used the cassettes in California and the charges made by the out-of-state laboratory for making the cassettes are subject to tax. 6/21/90.

330.2314.920 **Lessor Required to File Returns.** Lessor rents small pick-up trucks and cargo vans to customers of a retailer of other property (retailer) for short terms, generally three hours or less. The lessor has no rental locations other than the retailer's location. The vehicles are not mobile transportation equipment. The vehicles are rented by the customers at the retailer's service counters. The retailer's employees handle all facets of the rental arrangements, processing all paperwork and checking the vehicle in and out. The vehicle rental agreement between the lessor and the individual customer explicitly provides that the retailer is not a party to contract and accepts no responsibility or liability under the contract. The retailer collects the rental amounts on behalf of the lessor, and also adds and collects California use tax from the customers on the rental receipts. The transactions are recorded on the retailer's point of sales computer system, which tracks revenue and use tax collected. The contract between the retailer and the lessor requires the retailer to remit to the lessor the net proceeds from the rental agreements, less the use taxes collected and an agreed fee payable by the lessor to the retailer. The contract also states that the retailer assumes responsibility for the remittance of collected use tax to the governmental authorities.

A review of the actual contracts might indicate that the lessor will actually be leasing the vehicles to the retailer for sublease to its customers. Assuming such is not the case and the lessor is leasing the vehicles to the retailer's customer, the lessor is required to report and remit to the Board the tax due on the rentals payable by the lessees. That is, the retailer may not report the tax on its returns. Instead, the tax must be

reported on separate returns filed by the lessor. Of course, the lessor may authorize the retailer to act as its agent to prepare, sign, and file the returns on the lessor's behalf. Even if it does so, the retailer may not combine that return with its own return, but must file a separate return under the lessor's name. 1/29/97.

330.2315 **Lessor-Retailer's Sale of Vehicle to Lessee.** A lessor-retailer is required to pay sales tax, with respect to the retail sale of a motor vehicle to the lessee, when the lessor-retailer files a ''Report of Sale''. If a ''Report of Sale'' is not filed, the lessee is required to pay the use tax when the vehicle is registered with the DMV. 5/8/90.

330.2318 **Licensing of CD-ROM and Related Software.** An out-of-state corporation compiles data regarding proprietary oil and gas production information and places it on a CD-ROM. Copies of the CD-ROM and related software are furnished to licensees. The corporation retains rights to the data and the CD-ROM. The data is updated monthly by returning the original CD-ROM and receiving an updated one.

Since the customer must return the CD-ROM, the transaction is a lease. The corporation leases property in California that is not leased in the same form as acquired and is, therefore, a retailer engaged in business in this state. It is required to collect use tax from its California customers even though it does all of its business by mail order. 8/4/94.

330.2320 **Licenses.** A ''license'' allowing a licensee to use, in California, software which provides that the software must be returned to the out-of-state licensor at the termination of the license period, is a lease. The lessor has nexus with the state of California due to the presence of the software, and is required to collect use tax on the lease.

Seller making an outright retail sale of software is not required to collect use tax if the seller has no other contact with California other than through mail order sales of products delivered by carrier or the U.S. Postal Service. 7/8/93.

330.2321.500 **Lighting Equipment and Services.** A taxpayer provides lighting direction, lighting equipment and equipment operators to qualified motion picture producers. The charges for the services and the equipment are separately stated on billings to the producers. However, in no case is the equipment provided without the services.

The operating of lighting equipment does not result in a fabrication of any audio-visual embodiment and thus does not fall within the definition of ''qualified production services'' under Regulation 1529(b)(4). Also, the taxpayer is not leasing out its equipment since it requires the customer to contract for the taxpayer to operate the equipment. The taxpayer does not transfer possession or control of the equipment to the customer. Rather, the taxpayer makes use of its equipment. Therefore, the taxpayer is the consumer of the equipment used to provide lighting services and should pay sales tax reimbursement or use tax at the time of acquiring the equipment used to provide the services. 6/3/97.

330.2322 **Loan of Equipment to Customers.** A taxpayer sells blood analysis equipment and the chemicals used in the analysis. The taxpayer will also lend equipment to the users who enter into its Reagent Rental Plan Agreement in which the user agrees to purchase a stated dollar amount of reagent per year at an elevated price. Under this plan, the difference between the regular price for the reagent and the elevated price constitutes rental receipts for the use of the equipment. Whether these receipts are taxable depends on whether the equipment was acquired tax paid and rented in the same form as acquired. 10/25/74.

330.2325 **Maintenance Contracts.** A lessee has an option to select one of two maintenance contracts in connection with the purchase of a computer. One provides for a full-time on-site field engineer and all parts. The other provides for training of personnel for technical certification on the equipment and provides for two on-site inspections by a field engineer. The lessee does not have an option to contract with a person of his/her choice; rather, he/she must elect to take one of the two maintenance options available. These maintenance charges are not optional within the meaning of Regulation 1660, since, regardless of the type

of contract chosen, the lessee is required to contract with the lessor for maintenance. The charge must be included in the measure of tax. 2/18/91.

330.2330 **Maintenance Contract—Optional vs. Mandatory.** The fact that a purchaser with significant economic power is able to lease property without a maintenance contract is not indicative of whether a maintenance contract is optional or mandatory. A seller may have different policies for preferred customers. If non-preferred customers are required to contract for a maintenance contract, such contracts are mandatory and part of the gross receipts. 12/18/92.

330.2333 **Medical Monitoring Service.** A taxpayer provides an emergency response system to the customer. The service consists of an easy to use electronic device designed to signal a friend, relative, or emergency service whenever help is needed.

The taxpayer buys or leases these units from the company who does the monitoring from a center located out of state. The taxpayer bills customers separately stated amounts for rental and monitoring of the equipment. The taxpayer, in turn, pays the monitoring company for the purchase or lease of the equipment and the monitoring of all units in service.

The taxpayer acknowledges that the monthly fee charged to its customers for the equipment rental is subject to tax. The only question is whether the monthly fee for monitoring the equipment is subject to tax. The operation of the monitoring service is explained as follows. When a customer presses the button on the portable transmitter installed in the customer's home, it sends a radio signal to the receiver, which then dials the central monitoring system located out of state. The center then notifies one of the three emergency contacts designated by the customer at the time of installation of the unit. There is no charge for the number of times the system is used by the customer. Based on this unique situation presented by specific facts provided, the monthly fee for monitoring the unit is regarded as a nontaxable charge for services. Thus, the contract between the taxpayer and its customer is for both the lease (sale) of tangible personal property and the provision of services. In other words, the monthly fee for monitoring the equipment is not subject to tax. 7/15/96.

330.2335 **Mixing of Cement and Hazardous Waste.** A firm furnishes a truck with a mixer and driver to a customer. The firm mixes cement with the customer's hazardous waste to fabricate a solid which can be disposed of at a hazardous waste facility for solids. The total charge is subject to tax as fabrication labor.

Assertions that the driver and truck were ''leased'' to the customer are not borne out by the facts. There is no transfer of possession and control over the truck nor is there a lease. The firm is contracting to perform fabrication and is required to furnish all labor, materials, tools, equipment, facilities and services necessary to do the work. 1/13/93.

330.2340 **Motion Pictures.** Motion picture films purchased by lessors for rental service cannot be purchased under a resale certificate after August 1, 1965. section 6006(g) provides the lease of motion pictures is not a sale; thus the lessor is the consumer of such films and the sale to him is the retail sale. 4/25/66.

330.2350 **Motion Pictures—Use of Projector and Related Equipment.** A corporation engaging in providing motion picture films to restaurants and pizza parlors who supplies its customers with the projector and accessory equipment is subject to tax measured by the apportioned rental attributed to the projector and the related equipment. It was not reasonable to conclude that the corporation provided the equipment without charge, as an accommodation when the invested cost of the property amounted to approximately 77% of the total unit. 7/6/77.

330.2360 **Motion Pictures—Stock Shots.** Rentals of motion picture ''stock shots'' of animals in action are exempt from tax pursuant to section 6006(g)(1) even though the films are not complete productions. 2/19/68.

330.2368 **Motor Vehicle Subsequently Moved Out of State.** A motor vehicle which is leased is subsequently moved out of state by the lessee. When the vehicle is located outside California, the rentals payable are not subject to tax if the vehicle's registration address is the out-of-state address of use. If the lessor is unable to obtain the change in the vehicle's registration address, the lessor should either collect use tax measured by rentals payable or obtain and retain a valid explanation in writing from the lessee for the discrepancy between the registration address and the address of the vehicle's use outside California. 7/3/91.

330.2370 **Motor Vehicles—Interstate Transactions.** A taxpayer leased a car in Texas and within 90 days was transferred to California by his employer. In accordance with Texas tax law, the lessor had paid tax on the purchase price of the vehicle. A vehicle brought into the state within 90 days may be subject to use tax on the purchase price while one brought in after 90 days would not be subject to tax on the purchase price. [See note below.] Since the vehicle entered the state within 90 days from the date of purchase, the lessor has the option to pay California use tax on cost and receive a credit for Texas sales tax paid. If the lessor fails to make this timely election, use tax will be due on the rental receipts. In this case, although at the time the lease started the lessee did not know he was to be transferred to California, the possession of leased property by a lessee is a continuing purchase for use in this state and the lease payments are subject to use tax. The lessee is not entitled to an offset credit pursuant to section 6406 because the Texas tax was imposed on the lessor and the California use tax on rental payments is imposed on the lessee. 5/10/91. (Am. 2006–1; Am. 2008–1).

(Note: For the period October 2, 2004 through June 30, 2007, under certain conditions any vehicle, vessel, or aircraft purchased outside of California and brought into the state within 12 months from the date of its purchase is presumed to be acquired for storage, use, or other consumption in California and subject to use tax.) (Regulation 1620(b)(5).)

330.2376 **Nintendos and Segas.** Leases of Nintendos, Segas, and/or software are not within the exemptions for video cassettes, video tapes, and video discs provided by Regulation 1660(b)(1)(A). Leases of Nintendos, Segas, and/or software fall under the general leases of tangible personal property. If leased in the same form as acquired, tax is due on the rental receipts or the purchase price of the property as set forth under Regulation 1660(c)(2). 6/15/90; 7/10/96.

330.2380 **Nominal Option Price.** Where a contract with respect to relocatable classrooms binds the customer for a fixed term and the customer has the option to purchase at the end of the term, the option price is nominal and the contract will not be regarded as a true lease if the option price does not exceed $100 or 1 percent of the total contract price, whichever is the lesser amount. But if the customer has the contractual right to terminate the arrangement and relinquish possession at any time without purchasing the property, the nominal option price will not destroy the character of the contract as a true lease. 5/28/68; 6/5/68.

330.2421 **Nominal Rent.** Upon the exercise of the option to purchase a neon sign, tax applies to the amount required to be paid per the contract and not upon some predetermined amount. 6/23/69.

330.2435 **Nonprofit Organizations—Leases.** A nonprofit organization rents beds and medical equipment such as wheelchairs, walkers, crutches, etc., to people with HIV and AIDS. The equipment has been acquired by donation from a number of sources. Since the property was not purchased with sales tax paid and since the donor's donation is exempted from use tax by Revenue and Taxation Code section 6403, the use tax is due on the rental receipts from the leases or rentals of these beds and equipment. This tax application is correct unless the equipment qualifies as an exempt medicine pursuant to Regulation 1591(k). Contrary to common belief, there is no general exemption from the sales and use tax on sales made by nonprofit organizations. 4/22/93.

330.2441 **Occasional Sale—Property Acquired Under.** Company X manufactures equipment and transfers it to Company Y, a commencing corporation, solely in exchange for first issue stock. Y leases the equipment to Company Z, a related corporation. Y collects use tax from Z on the rental receipts. At the termination of the lease to Z, Y uses the equipment itself. Because Y did not acquire the property by purchase, no tax is due on the use of the equipment by Y.

The initial transfer by X for first issue stock of Y results in use tax due by X on the purchase price of the equipment component parts which had been acquired for resale. The transfer of property in exchange for first issue stock is considered a use. 4/26/95.

330.2450 **Oil Well Drilling Rig.** A lease of an oil well drilling rig has occurred when all of the following apply:

(1) Although lessor has a supervisor at the jobsite who direct drillers as to how much weight and pressure to apply, the actual drilling operations are done by the customer's employees on rigs of the lessor;

(2) Lessor is not responsible for any damage that may result in the drilling operation;

(3) If any tools are lost or damaged in the well, the customer is responsible for them, and

(4) Lessor is not responsible for the results of the drilling operations. 7/10/68.

330.2460 **Operating and Lease Agreement.** The owner of a hotel contracted with a management company, to operate the hotel under an ''Operating and Lease Agreement.'' Under the terms of the agreement the operator/lessee was to operate the hotel subject to specific limitations, which are not generally consistent with a lessor/lessee agreement. The agreement imposed limitations on legal proceedings, concession agreements, large expenditures, employees salaries, and labor relations. In addition, there was no provision in the agreement for rent. The operator/lessee received a fee equal to a percentage of the total revenues, and the owner/lessor, was to receive the gross operating profits.

In a typical lease arrangement, the lessor receives a rental consideration consisting of a fixed amount or of a fixed amount plus a percentage of gross receipts, and the lessee is the party at risk for the profitability of the business. However, in this case, the ''lessor'' is not guaranteed any ''rental'' payments, nor does the ''lessee'' have any risk for the profitability of the business because its remuneration is a percentage of gross revenues. As such, the agreement is a management contract, not a lease and no tax is due on the ''lease'' payments related to the tangible personal property used in the hotel. 4/23/91.

330.2463 **Operator Provided Sound Equipment.** A taxpayer is engaged in the sale and lease of sound systems and sound equipment such as horns, speakers, microphones and stands, and amplifiers. The taxpayer entered into an agreement with a movie studio to furnish a fully energized sound engineering system, the services of a sound engineer, and the tools necessary to operate the system. The agreement required the sound engineer to maintain, supervise, and personally operate the sound system. Further, all personnel provided by the taxpayer were deemed to be the taxpayer's employees.

In a true lease, the chief characteristic is the giving up of possession to the lessee, so that the lessee and not the owner uses and controls the rented property. Under the facts of this particular arrangement, the taxpayer did not transfer control of the sound system to the customer. Rather, the taxpayer maintained control of the sound system in that at all times, the sound engineer controlling and using the sound system was an employee of the taxpayer and under the taxpayer's control. Thus, this is not a true rental agreement. The gross receipts from this agreement are not subject to the tax. Rather, the taxpayer is the consumer of the sound system it used to fulfill the agreement and tax applies to the sale of the sound system to the taxpayer or to the taxpayer's use of the property, measured by the purchase price. 2/7/96.

330.2465 **Operators Provided in Connection with Leases of Tangible Personal Property.** If the owner of the property always provides the operators, i.e., the owner will not provide the property without its operator, the transaction is not a lease. The charges made by the owner are regarded as charges for nontaxable services. The owner of the property is the consumer of the property and tax is due measured by the purchase price of such property.

If the person desiring to use the property has the option to obtain the property with or without an operator, the transaction is a lease even if the owner of the property provides the operator. In those transactions in

which the owner of the property provides the operator and the lease payments are subject to tax, the measure of tax will include the charges for the rent but will not include the charges for the operator's services. 8/5/93.

330.2473 **Option to Obtain Services of Operator.** If a lessee has the option of obtaining the leased property with or without an operator furnished by the lessor, the transaction will be taxed as a lease. If the lessor did not purchase the property tax-paid, tax will apply to lease receipts. If the property is leased in substantially the same form as acquired, the lessor may elect at the time of purchasing the property to pay tax or tax reimbursement on the purchase price. In that event, tax will not apply to lease receipts and it will not matter if the furnishing of an operator by the lessor is optional or mandatory. 12/9/93.

330.2480 **Option to Purchase.** There would be a tax due upon the exercise of an option to buy by the lessee and the tax would be due upon the specified selling price, i.e., amount paid by the lessee upon exercise of the option to purchase. 8/5/65.

330.2482 **Option to Purchase.** A contract for the lease of tangible personal property includes an option to purchase. Although the contract term is 60 months, the lessee may make an election which becomes effective at the end of the 54th month of the contract term. The customer can continue to make payments on the equipment covered by the agreement for the remaining six months, and will obtain title to the equipment. Alternatively, the customer may return the equipment to the lessor at the end of the 54th month. If the customer fails to make a timely election to return the property, then it is regarded as having elected to continue making payments on the equipment through the remainder of the 60-month term.

Since the lessee has a true right to terminate the agreement at the end of the first 54 months, it is a true lease for that period. If the lessee elects to continue to make payments (or fails to make an election), the lessee is certain to gain title to the property. Therefore, unless the lessee makes a timely election to return the property after the 54th month, the lessor makes a sale at inception at the end of the 54th month. 4/16/92.

330.2483 **Option to Purchase.** Tax applies to the amount required to be paid by the purchaser upon the exercise of the option. This is the case whether the lessor had elected to pay tax measured by the purchase price or if the lessor instead collected tax from the lessee measured by rentals payable, since the purchase by the lessee is a separate retail transaction from the lease. In a sale and leaseback transaction which is a financing transaction, the buy out at the end of the ''lease'' term is not subject to tax because it is not a ''sale'' under section 6006. 2/6/90.

330.2484 **Option to Purchase.** A lessor of musical instruments, reporting tax based on rental receipts, allows lessees to apply up to six months of rental payments to the sales price of the instrument when the lessee exercises his option to purchase. The sales price of the instrument pursuant to Regulation 1660(c)(7) is the amount required to be paid by the purchaser upon the exercise of the option. This applies whether or not instrument purchased was the one that the purchaser had been leasing. The seller is allowing a discount or price adjustment to the selling price of the article and the net amount required to be paid by the purchaser is subject to tax. 6/28/72.

330.2500 **Option to Purchase Exercised After Tax Rate Change.** Where a lease with option to purchase was executed prior to the date of a tax rate change, rental payments made before that date were subject to tax at the prior rate of tax and thereafter at the new rate of tax. If the option to purchase is exercised on or after that date the gross receipts from the sale will be subject to tax at the new rate. (Refer to section 6376.1 which contains several grandfather exemptions for leases that are continuing sales and purchases if the leases are for fixed amounts and where the seller or purchaser is under an obligation.) 8/16/67.

330.2520 **Option to Purchase Exercised After Expiration of Lease Term.** A lease of a fixture is a lease of tangible personal property under section 6016.3 where the lessor has the right to remove property upon breach or termination, and the lessor is not the lessor of the realty. If, under the terms of the lease the lessee has an option to purchase the property, a sale of tangible personal property results when the option is exercised even if it is exercised after the expiration of the lease term. 4/1/68.

330.2522 **Option to Purchase—Fair Market Value.** A lessor leases equipment to hospitals. All equipment leased is purchased tax-paid and leased in substantially the same form as acquired. For its service of obtaining the equipment and leasing it, the lessor collects a service fee from the lessees at the time the leases commence. The service fee is 3% of the cost of the leased equipment. The lease period is five years and, in some cases, the lease provides the lessee with an option to purchase the equipment at the end of the lease for fair market value. In some instances the fair market value is a nominal amount.

When the parties are dealing in good faith knowing that in a high technology ever-changing area they would let the marketplace dictate the option price, the fact that fair market value might be nominal at leases end would not alter the conclusion that the above leases are true leases with bonafide options to purchase. Since the leases are true leases which are in a tax-paid status, the 3% service fee which the lessor charges the lessees at the commencement of the leases is not subject to tax. 2/25/83.

330.2522.600 **Option to Purchase Price Paid in Advance.** Equipment with a combined value of $231,000 was leased for a fixed term of five years. The lease called for a monthly payment of $4,537.15. By the terms of the contract, title to the equipment remained in the lessor and lessee had the option to purchase the equipment which may be exercised during the last six months of the lease term. However, the option purchase price of $23,189 was required to be paid in cash at the time of the execution of the lease agreement.

Even though the option price was more than a nominal amount (Regulation 1660(a)(2)(A)), the requirement that the purchase price be paid in advance in effect renders the true option price to be paid at the end of the lease to be zero dollars. In other words, at the end of the lease term, the only requirement to exercise the option will be for the lessee to give written notice to the lessor. Also, Regulation 1641(b) states that if property is for all intents and purposes sold, but is treated as a leasing agreement for purpose of retaining title in the seller as security for payment of the purchase price, the transaction is deemed to be taxable as a sale under a security agreement. Therefore, the lease constitutes a present sale of the equipment and subject to tax at its inception of the lease. 6/30/86.

330.2523 **Option to Purchase—Selling Price.** Late charges and property tax payments required to be paid by the delinquent lessee at the time the lessee exercises the option to purchase leased property at the end of the lease period are not part of the consideration paid to obtain title to the property. The late charges and property tax reimbursement due and owed to the lessor are amounts which the lessee is contractually required to pay as part of the lease agreement. Such amounts are payable without regard to whether the option is exercised. 3/15/90.

330.2525 **Optional Services—Lease of Audio Equipment.** Company A rents audio visual equipment for short periods (generally 1 to 4 days) and reports tax on rental receipts. A typical agreement obligates Company A to supply audio visual equipment, a video wall processor, a computer (programmed by Company A) and other equipment required for video production. In addition, the lessee may request some or all of the following optional services:

(a) Delivery and pickup of the equipment

(b) A crew to set up the equipment

(c) An engineer to operate the equipment

(d) A crew to take down the equipment

(e) Custom computer programming

Charges for the rental of the equipment and any optional services are separately stated when billed to the lessee. Under the above stated scenario the application of tax to the optional services are as follows:

(1) Delivery and pickup.—If delivery is by the facilities of the lessor the charge is taxable, unless the lease commences prior to the property being delivered to the lessee. If delivery is by common or independent carrier, the charge is not subject to tax, unless the property is leased for a delivered price. When property is leased for a delivered price, the charge for the delivery is taxable unless the lease commences prior to the property being delivered to the lessee. The charge for optional pick up services are excludable from tax.

(2) Set up and take down.—Optional set up charges are excludable from the measure of tax provided the set up occurs after the lease commences. The charge for optional take down services is also excludable from tax.

(3) Engineer to operate the equipment.—If providing an engineer is truly optional and if the lessee actually gains control of the equipment, the charge for the engineer is not taxable.

(4) Custom computer programming.—The charge for custom computer programming, as defined in Regulation 1502, is not subject to tax; however, any computer program in existence at the time the lease contract is executed, is not custom programming for purposes of the sales and use tax and the charge for using such a program would be subject to tax.

Sometimes the lessee will contract to sublease the equipment, including the engineer, to others. In this case, tax will not apply to the rental receipts, provided the lessor accepts a valid resale certificate for the lease, which is timely taken and accepted in good faith. However, the same analysis applicable to whether the transaction between the lessor and the lessee is a true lease, is also applicable to the transaction between the lessee and the sublessee. That is, who has the actual control of the equipment and whether the charge for the additional services are truly optional with the sublessee. 10/1/92.

330.2527 **Options Available to Lessor.** A corporation which does not have a seller's permit is owned by a single shareholder. It uses heavy equipment including trucks which the corporation owns or leases from independent leasing firms. The trucks and equipment are acquired tax paid by the corporation and the independent leasing firms. The corporation now wishes to sell the equipment which it owns to the single shareholder and lease it from him. The options available to the lessor/shareholder, the tax consequences upon the sale of the equipment from the corporation to its shareholder, and the leaseback of the equipment sold are as follows:

(1) The lessor/shareholder may place the heavy equipment, including the trucks, on a tax-paid basis by paying use tax based upon the purchase price of the property. Use tax on the trucks would be paid directly to the Department of Motor Vehicles. Use tax on the other heavy equipment must be paid directly to the Board in the calendar quarter in which the equipment is first placed in leased service (see section 6094.1). If tax is paid on the cost of all the heavy equipment, tax will not apply to the rental charges made by the proprietorship to the corporation.

(2) The lessor/shareholder may apply to the Board for a seller's permit and may acquire all of the heavy equipment for resale. If this approach is taken, the lessor would be required to collect tax from the corporation based upon rental receipts paid by the corporation.

If neither of the above options are chosen, the lessor/shareholder's inventory will consist of ex-tax inventory except for the trucks. The equipment, except for the trucks, qualifies for a tax free occasional sale. The lessor will be required to pay use tax measured by the purchase price of the trucks at the time the trucks are re-registered at DMV. The lease of the heavy equipment, other than trucks, would be taxable because the lessor would not have paid tax measured by the purchase price pursuant to Regulation 1595. The lease of the trucks would be nontaxable because the lessor would have paid use tax measured by the purchase price of the vehicles.

It is immaterial that the lessor may be a corporation (rather than a proprietorship) wholly owned by the same stockholder who owns the lessee. 3/24/93.

330.2529 **Out-of-State Use of Leased Property.** A company in the business of renting theatrical rigging equipment purchases the equipment without paying tax. The majority of the rentals are to musical touring groups or corporate shows. The actual use of the equipment takes place all over the U.S. and sometimes outside the U.S. The customers are also located all over the U.S. and abroad. Every possible location combination occurs (i.e., client outside the state with use inside the State, client inside the State with use both inside and outside the state, etc.).

Use tax applies only with respect to those periods the leased property is situated in this state. If the property is delivered to a carrier for shipment out of state and the lessee delivers the property to a carrier for delivery back to the company, (the lessee having no possession of the leased property in this state) no tax applies. If the contract provides that the property will not be used in this state, but the lessee acquires possession in this state (that is, the lessee picks up the property, drops off the property, or both) use tax applies to any such periods of possession in this state. If the property will be used both inside and outside California by a touring lessee, the tour itinerary would be sufficient evidence of out-of-state use provided that the leased property was used inside and outside California in conformity with the itinerary. The itinerary should be retained in the lessor records. Rentals for any period the property is situated in California are subject to tax even if the property is between engagements or en-route. 11/24/87; 2/25/88.

330.2530 **Out-of-State Use of Leased Property.** A lessor purchases tangible personal property (none of which is mobile transportation equipment) for resale from suppliers both inside and outside California. The first lease is at a location outside California. Following termination of this first lease, the lessor brings the property into California, not for lease to another lessee, but for use in the lessor's own operations in California.

If the property was purchased by the lessor outside California, and does not enter California within 90 days of the start of the out-of-state lease, the lessor's use of the property in the lessor's own operations in California is not subject to use tax.

If the property was purchased by the lessor inside California, and did not reenter California until after six months from the start of the out-of-state lease (section 6009.1), the lessor's use of the property in the lessor's own operations in California is not subject to use tax. 3/17/88.

330.2540 **Out-of-State Lessor.** An out-of-state lessor is required to collect and remit California use tax from the lessee on leased tangible personal property located and used in this state even though the lease was entered into in another state. 9/2/69.

330.2541 **Out-of-State Lessor.** A foreign lessor leases equipment to a British firm. The British firm has an affiliated corporation operating in California. The lease permits the transfer of the equipment only after it has been delivered and leased in the United Kingdom. The British firm plans to ship the equipment to California and sublease it to the affiliate for the same amount as it pays the foreign lessor.

Under these circumstances, the sublease by the British firm is subject to tax unless the foreign firm opts to pay California use tax on the purchase price of the equipment, or the British firm opts to pay California use tax on its lease payments. The foreign lessor may not elect to pay use tax on cost unless the equipment was purchased for use in California. Thus, if the property is purchased outside the state and first functionally used outside the state and it is not brought into the state within ninety days, there is no election to pay use tax on cost by the foreign lessor. 11/29/95.

330.2550 **Out-of-State Prior Lease.** In March 1994, the lessee took delivery of a vehicle in Illinois. The vehicle did not enter California until January of 1995, when the lessee relocated to California. At the time of delivery of the vehicle to the lessee in Illinois, the lessee paid an amount as ''sales tax'' on the base cost of the vehicle.

Since the vehicle was used outside of California for over 90 days prior to its entry into this state, the lessor is not regarded as having purchased the vehicle for its use in California. [See note below.] This means that the lessor would owe no California use tax on its own use of the vehicle in this state, and thus the option of

paying tax on the purchase price of the vehicle is not available to it. The lease constitutes a continuing sale and purchase, for which the lessor must collect use tax on the lease receipts from the lessee.

The lessee's payment of ''sales tax'' appears to be either reimbursement to the lessor for tax or tax reimbursement it paid or it was a payment made to Illinois on behalf of the lessor for tax liability imposed upon and owed by the lessor on its purchase price of the vehicle. The lessee may not take credit against its use tax liability for any taxes paid by or paid on behalf of the lessor on its purchase price of the vehicle. 8/25/95. (Am. 2006–1; Am. 2008–1).

(Note: For the period October 2, 2004 through June 30, 2007, under certain conditions any vehicle, vessel, or aircraft purchased outside of California and brought into the state within 12 months from the date of its purchase is presumed to be acquired for storage, use, or other consumption in California and subject to use tax.) (Regulation 1620(b)(5).)

330.2560 **Out-of-State Use of Leased Equipment.** An out-of-state company has several jobs offshore of California. The company is a lessee of tangible personal property (not MTE) for use in waters outside California. The leases are continuing sales and purchases.

If the leased property is not situated in California during the lease term, no California use tax will be due on the rental payments. If the property is inside California during any portion of the lease term, use tax will apply for the period of time the property is inside the state unless the section 6009.1 exclusion applies. For example, if the company was to store the property in California for the purpose of subsequently transporting it to waters outside California for use solely outside this state, such storage would come within the section 6009.1 exclusion, and the company would not owe California use tax on such storage. However, the company will owe use tax if it makes any use of the property in California other than the storage or other exercise of a right or power over the property for the purpose of shipment outside this state for use solely outside this state. 1/3/96.

330.2570 **Parking Gates and Door Locks.** Parking gates and door locks are fixtures and are to be treated as tangible personal property when leased with the right of removal by the lessor when the lessor is not also the lessor of the realty to which the items are affixed. Accordingly, tax is due on the lease receipts when the items are not acquired tax paid and leased in substantially the same form as acquired. 9/16/77.

330.2573 **Partnership Interests.** A and B were equal partners in a business. The partnership purchased equipment tax-paid for use in the business. A withdrew from the partnership and sold his interest to C, D, E and F. There was no written agreement providing that this change would not cause a dissolution of the original partnership. Therefore, the partnership of B and C, D, E and F is regarded as a new partnership.

Simultaneously, B and C, D, E and F formed a corporation. They transferred all assets of the new partnership other than equipment to the new corporation solely in exchange for first issue stock. The new partnership leased the equipment to the corporation.

Tax applies to the rental receipts. The equipment does not retain its tax-paid status in the hands of the new partnership. There is no method for placing the equipment in tax-paid status because it was transferred to the new partnership by C, D, E and F solely in exchange for ownership interests in the new partnership. 3/11/75.

330.2575 **Partnership Transactions.** Two individuals formed two identical partnerships. One partnership manufactured tangible personal property which it sold to the second partnership for purposes of lease. The manufacturing partnership paid sales tax with respect to the gross receipts from the sales to the leasing partnership. The leasing partnership then leased the property without collecting or paying tax on lease receipts.

The partnership laws of California (Corp. Code sections 15001–15045) follow the aggregate theory, and under such theory a partnership with identical partners under one partnership name is the same partnership, (*Park* v. *Union Mfg. Co.* Cal.App.2d 401). Accordingly, for Sales and Use Tax purposes, there was only

one partnership. Therefore, tax was not due on the transfer of the property from the manufacturing operation to the leasing operation. A person cannot sell to himself. Tax was due based on rental receipts. 12/3/76.

330.2577 **Pay Television Providing Home Terminal Units.** Company A is engaged in the pay television business. In return for periodic payments, it contracts with individual retail customers to provide them with television programming.

In order to receive the company's programming, each customer must be a subscriber to a CATV antenna system. Since Company A does not have any CATV antenna system, the customer must separately contract with Company B. Company B is unrelated and it also offers programming of its own. When a customer contracts to receive Company A's programming and is connected to a CATV antenna, Company A attaches its ''home terminal unit'' to the customer's television receiver. Without the home terminal unit provided by Company A, the normal television receiver will not display Company A's programming. The only possible function of the unit is to unscramble signals which Company A generates in its television studios and transmits over the CATV antenna systems of Company B which connect Company A's studio with the customers' television receivers. Company A charges a refundable deposit and a nonrefundable installation charge when the agreement is initially made with the customer. A single periodic charge is made for programming (including the home terminal unit) provided by the company during that period.

For purposes of the Sales and Use Tax Law, Company A is not renting or leasing the home terminal units to the customers but is using the home terminal units to provide the customer with programming services. 11/18/75.

330.2580 **Personal Computers.** A taxpayer is in the business of renting personal computers to the public for use within its store at $10.00 each hour. Either the taxpayer or the customer provides the software. Also, a laser printer is provided to produce a finished copy at an additional price for each print.

Lease excludes a use of a property for a period of less than one day for a charge of less than $20.00 when the use is restricted to the grantor's premises. (Revenue and Taxation Code section 6006.3). The lessor is the consumer of the personal computer and laser printer, and tax applies to the sale of the items to him. If the charge exceeds $20.00 per day, the transaction is a lease; however, if the equipment is purchased tax paid and leased in substantially the same form as acquired, the lease is not subject to tax. 1/3/90.

330.2600 **Photographers—Lease of Photographs.** If possession and use of a photograph is temporarily transferred for a consideration the transaction constitutes a lease within the meaning of section 6006.3 regardless of whether reproduction rights are granted by the lessor. For the period November 10, 1969 to July 14, 1991 section 6362(b) of the Revenue and Taxation Code exempts from the tax the sale and use of photgraphs when the posession, but not the title, is transferred for the purpose of being reproduced one time only in a newspaper regularly issued at average intervals not exceeding three months. 10/2/67.

330.2620 **Plans and Specifications—Trimaran Construction.** The granting of temporary possession of a reproduced design plan of a trimaran, which remains the property of the designer and is returned when the California customer has completed the trimaran, is a lease. 7/16/68.

330.2650 **Possession and Control Requirement.** If possession and control of the property in question are not transferred to the purported lessee, and the purported lessee does not have the option of obtaining the property without also obtaining the services of the lessor (or the lessor's employee or agent) who maintains possession and control of the property, then the transaction is not a lease. Rather, the purported lessor is actually using the property. *Entremont* v.*Whitsell* (1939) 13 Cal.2d 290. For example, if a photographer ''leases'' his camera but insists upon taking the pictures himself, refusing to transfer possession and control of the camera to the ''lessee,'' then the ''lessor'' is not regarded as leasing the camera, and would not be entitled to purchase that camera for resale. 6/29/92. (Am. M99–1).

330.2660 **Possession Retained by Owner.** A person engaged in rendering services is the consumer of the tangible personal property used by him in rendering the service even though it may be delivered to the

customer's premises and actually used there when possession, custody, and license to use the equipment remains totally in the hands of the owner or his employees. Such a transaction is not a lease for purpose of sales and use tax. 5/16/66.

330.2665 **A Promise Is Consideration for Lease of Equipment.** The customer, pursuant to an agreement, promises to purchase a minimum of 50 test packs per day for 180 days at a stated price per test pack. In return, the customer is entitled, among other things, to possession and use of an automatic clerical analyzer and computer. Under such circumstances, a lease of the equipment is clearly in evidence since consideration in the form of the customer's promise to purchase a certain quantity of the test pack is given in return for possession and use of the equipment. A ''loan for use'' is not in evidence, since the lessor realizes ''reward'' in the form of the promise to purchase and actual purchases by the customer of the test packs. 11/1/85.

330.2667 **Property Acquired and Used Under Occasional Sale.** Company X purchases tangible personal property ex-tax for resale. Rather than reselling the property, Company X contributes it to Company Y in a nontaxable commencing corporation transfer. Company Y leases the property to Company Z. Companies Y and Z thereafter merge.

Company X is required to report and pay use tax on its purchase price of the property. It improperly purchased the property for resale since its intent was to transfer the property to Company Y in a nontaxable commencing corporation transaction and not to resell the property. Company Y's lease of the property to Company Z is subject to tax since Company Y did not pay tax on its purchase price (nor could it since it did not purchase the property). Company Y's use of the property is not subject to tax without regard to whether such use occurs upon termination of the lease or after merging into Company Z.

This situation differs from Annotations 330.3650 (12/11/86) and 395.2150 (9/23/71) in that in these annotations, it is the disappearing company's purchase price of the property purchased for resale that is subject to tax if, after the merger, the surviving company uses the property rather than reselling, as is often the case when one of the parties to a merger was making a taxable lease of property to the other party to a merger. This rule does not apply here since the lessor was not a purchaser and could use the property itself (as opposed to selling it in a lease or otherwise) without tax liability. 8/25/97. (M98–3).

330.2668 **Property Rented in Nevada.** A taxpayer, located in California, rents property to Nevada customers. The property includes garments, towels, and other such items.

Since the items purchased for rental include items which involve furnishing the recurring service of laundering or cleaning, the taxpayer is the consumer of the items. Also, the items are regarded as being used in California . Thus, the taxpayer may not purchase the property ex-tax for resale. 9/13/88.

330.2670 **Purchase of Equipment by Parent Corporation for Use by a Subsidiary.** A corporation purchased equipment ex-tax and transferred the equipment to its parent corporation ex-tax. The parent makes periodic charges to the subsidiary for use of the equipment. All charges are made on the books of the corporations. Payment for the equipment to the supplier is sometimes made by the subsidiary and sometimes by the parent. There is no written agreement between the parent and the subsidiary.

Inasmuch as the corporations are related, the transactions could have been cast in any form desired by the parties. The transaction was cast in the form of a sale to the parent and leaseback. Tax should be applied based on the form in which the transaction was cast. The subsidiary's original purchase was for resale. The sale to the parent was a sale for resale by way of lease. Since the parent failed to make a timely election to pay tax on cost, tax applies to lease payments. 5/31/94.

330.2675 **Purchase, Lease, and Resale.** A California bank entered into a lease agreement with an out-of-state vendor to lease 10,000 merchant card reader terminals. The original lease required the bank to make 36 monthly payments broken down between principal, interest, and use tax on the lease payments.

After the terms of the lease were set, the bank and vendor agreed to amend the lease to include a purchase option price of $1.00 at the end of the lease for all 10,000 machines. At about the same time, both agreed to another change which would allow the bank to transfer ownership of the terminals to the merchants prior to the termination of the original contract which commenced on January 30, 1993.

On November 1, 1993, the bank reached an agreement with an unrelated Company to transfer ownership of the 10,000 terminals to it. Under the agreement, the Company subleased the terminals from the bank under the exact same terms as the bank's main lease with the out-of-state vendor. As of the sublease date, the bank utilized the terminals acquired from the vendor in a variety of ways. Some were still in inventory awaiting future lease to merchants. Others were lost, sold, given away, leased free of charge, and some remained in the bank's repair pool.

The original lease contract, as amended, is considered to be a sale under a security agreement from inception and not a true lease. (Regulation 1660(a)(2)(A).) Since the vendor is located out of state, the applicable tax to the transaction is use tax on any use of the terminals in the state by the bank. Since the bank is also holding some terminals in resale inventory, has sold terminals and has leased terminals for a monthly rental, the sale of these terminals to the bank is a sale for resale. The sales price of each category should be based on the per unit purchase price less interest and finance charges (if adequate and complete records were kept of such charges by the vendor).

Sales tax applies to the bank's subsequent retail sale of terminals to merchants. Likewise, use tax applies to the bank's subsequent lease of the terminals to merchants; that is, the bank is required to collect use tax on the rental receipts.

As noted, the bank had disposed or lost some of the terminals prior to the subsequent transfer of the units to the Company. If the Company contracted to pay the same amount to the bank, that the bank originally agreed to pay the vendor, then the bank sold the Company fewer terminals, (only those still on hand) for the same price the bank paid for the 10,000 terminals. The unit selling price should be determined based on the remaining terminals. Accordingly, the application of tax to the bank's sale to the company is as follows:

The sale of the terminals which are leased to merchants is a sale for resale. The Company does not have an option to pay sales tax reimbursement to the bank and consider the lease as nontaxable. (Regulation 1660(c)(9)(A).) The Company may elect to purchase for resale or pay sales tax reimbursement to the bank on the sale of terminals in the bank's inventory depending upon the planned disposition of these terminals. The sale of the terminals which are committed to the repair pool is a retail sale subject to sales tax. Also, the sale of the terminals loaned at no charge to merchants is a retail sale if the Company will continue to provide them to the merchants at no charge. 8/22/94.

330.2715 **Qualified Production Service.** A person is engaged in the business of creating masks and models (items) that are used to generate ''special effects'' in motion pictures. The items are built of wood, plastic, rubber and other synthetic materials. There is no transfer of legal title but there is a transfer of possession of the items to the customer. In some instances creators of the items accompany the items to the filming location and manipulate the items in the course of filming. The filming is done by other persons.

When a person transfers possession of the items to the customer in this state or operates models under direction and control of the customer, there is a lease of tangible personal property under Regulation 1660(a)(1) rather than a ''qualified production service'' under Regulation 1590(d). 12/20/91.

330.2715.600 **Radio Commercials Delivered Electronically.** A taxpayer is in the business of sending radio commercials from recording studios hired by their customers (advertising agencies) directly to radio stations through a multimedia communications network established by the taxpayer. The multimedia communications network is comprised of Record Send Terminals (RST's) located at various recording studios, and Receive Playback Terminals (RPT's) located at radio stations. The RPT's and RST's communicate with the taxpayer's Network Operations Center located in California through standard telephone lines. The recording studios do not pay taxpayer for use of the RST's or RPT's. Rather, taxpayer provides such equipment to them free of charge.

The RST's and RPT's are essentially customized multimedia computers (equipped with modems) that are either purchased or leased by the taxpayer, with the taxpayer paying sales tax reimbursement or use tax resulting from the purchase or lease. The Taxpayer's Network Operations Center functions essentially like a switchboard, receiving radio commercials from an RST located at a recording studio and routing the radio commercial to the appropriate RPT at the radio station.

The taxpayer's charges to advertising agencies are based on the number of commercials distributed at one time to a radio station on the agencies' behalf and the time frame within which the distribution is made. In cases where a radio station is not part of the taxpayer's multimedia communications network, i.e., the radio station does not have an RPT on-site, the taxpayer will transfer the radio commercial onto audio tape at its out-of-state facility and have the tape delivered by courier to the radio station. In those instances, the taxpayer pays sales tax on the purchase price of the blank tapes.

Under the facts presented, the taxpayer is regarded as using the RST's and the RPT's itself, rather than leasing them. The charges made by the taxpayer are not for the RST's and RPT's, but for the transmission of the recordings. The transfer electronically of the radio commercials from the recording studios to the radio station through the taxpayer's multimedia communications network is not a sale of tangible personal property and, therefore, is not a taxable transaction.

On the other hand, when the taxpayer's out-of-state facility copies a radio commercial onto audio tape and then sends the audio tape to a radio station in California, there is a transfer of tangible personal property, the audio tape. Since the taxpayer is a retailer engaged in business in California, the transfer of the audio tape for a measurable monetary consideration to a radio station in California is a taxable transaction. The measure of tax for the transfer of the audio tape is the sales price of the unprocessed recording media (the blank audio tape). (Regulation 1527(a)(1).) 1/4/96.

330.2715.900 **Real Estate Signs.** A taxpayer is in the process of becoming a franchiser. Its primary business will be manufacturing complete units of real estate signs including frames, signs, and stakes. The units will be sold to its franchisees who will in-turn rent them to local real estate offices. The franchisees' services will include the placement and removal of the unit. Some models will include riders (additional signs). The franchisees will lease the units to their customers in the same form as acquired. The units may not be modified but may include, as an option, the changing of riders.

Even though a rider on some units may be changed depending on the lessees' desires, such changes take very little effort. The franchisees would be leasing the units in the same form as acquired. The franchisees may, therefore, elect to pay the franchiser sales tax reimbursement or timely pay use tax measured by the purchase price and lease the units with no further sales or use tax being due. Alternatively, they may issue a resale certificate and collect use tax from their lessees measured by rentals payable. 5/20/88.

330.2715.905 **Refund of Tax Incorrectly Collected on Rental Receipts When Transaction Is a Sale at Inception.** A taxpayer requested a refund of taxes incorrectly collected and reported on rental receipts on a contract designated as a lease which was actually a sale at inception. The taxpayer is entitled to a refund only if the payments he has made exceed the amount he should have paid as provided in Regulation 1641 with respect to the sale at inception, taking into account any interest due for late payment of such amount. 8/22/97. (M98–3).

330.2715.910 **Rental Agency Lease to Car Dealer.** A car rental agency rents cars on which it reports tax on rental receipts to auto dealers for the following purposes:

(1) The car dealer furnishes the vehicle to its customers while the customer's car is being repaired pursuant to a mandatory warranty on which tax was reported and paid. The furnishing of the vehicle is required by the warranty.

(2) The car dealer furnishes the vehicle to its customer who is a lessee of a vehicle for which the dealer is reporting tax on rental receipts during the period the lessee's car is being repaired.

(3) Same as 2 except the dealer has paid tax on cost of the leased vehicle rather than rental receipts.

Under situation 1, the lease to the dealer is a sale for resale since the loaner is required by the original contract on which tax was paid. Under situation 2, the lease to the dealer is for resale whether or not it is required by a mandatory warranty because the loaner is regarded as part of the taxable continuing sale. Under situation 3, the dealer is the consumer and tax is due on the rentals payable by the car dealer, whether or not the loan is required by the lease agreement. 4/17/97.

330.2716 **Rentals of Mail Boxes.** Rentals of mail boxes which are fixtures incorporated into a building are not subject to tax on rental receipts. The ‘‘rental’’ is not of the mailbox but rather a lease of space in the facility. 2/1/90.

330.2717 **Rentals Payable.** An artist furnishes artwork to churches, but retains title to the artwork. In some cases the church pays her a specified amount. In other instances the churches ‘‘contribute to my life with the best that they can do, so that their money can enable my time to be continuously spent doing this work.’’ In both cases, from the facts presented, the artist has agreed to supply art in exchange for the churches paying her something. Since the artist retains title to the art the transaction is a lease of property which is not in the same form as acquired. Tax is due on rental receipts. 1/12/90.

330.2718 **Rental on Premises of Computers, Printers and Typewriters.** A taxpayer charges customers for the use of computers, printers, and typewriters on the taxpayer’s premises. If the rental is for less than one day and the charge is for less than $20, the transaction is not regarded as a lease and tax is not due on rental receipts. The taxpayer may not purchase the equipment for resale. If an additional charge per page is made for printing documents, tax applies to the charge. 6/24/94.

330.2719 **Renting Medical Ventilators to Hospitals.** A lessor rents ventilators to hospitals, usually on an hourly or daily basis. The lessor only rents to hospitals because the expertise of a respiratory therapist is needed to correctly operate the equipment. The hospitals use the ventilators for patients who need assistance to breathe. Possession or control of the equipment is not passed to the hospital’s patients since the ventilators are too complicated to be operated by anyone but a trained respiratory therapist.

The hospital is not considered to be sub-leasing or reselling the ventilator to the patient merely because it bills the patient for use. The equipment is being used by the hospital in providing a service. Also, this transaction does not qualify for exemption under section 6369.5 since it must be rented to an individual, not to a hospital, in order to qualify for the exemption. Accordingly, the rental charges to the hospital are subject to tax. 3/11/92.

330.2720 **Resale Certificates—Lease Contracts.** Lessors may issue resale certificates to their suppliers and pay tax on rental receipts if they so desire, rather than paying sales tax reimbursement to their vendors or paying use tax on the purchase price of the property. This is unchanged by the amendments effective August 1, 1965. When property is acquired from a nonretailer, e.g., as a trade-in, the tax being inapplicable to the acquisition of the property because acquired from a nonretailer, subsequent rentals of the property are taxable. 8/3/65. (Section 6094.1, added by Statutes of 1966 but operative July 1, 1965, provides an election to the purchaser of property acquired in an occasional sale from a nonretailer to pay tax measured by his purchase price and avoid tax on his rental receipts.)

330.2760 **Reversionary Interest—Sale of.** The transfer of the reversionary interest in leased equipment by the lessor to a person, who continues to lease the equipment to the same lessee and collects use tax measured by rental receipts, is exempt from sales tax as a sale for resale. 4/14/70.

330.2765 **Rights to Use Photo.** A firm is engaged in the business of licensing the use of its photos in various publications, advertisements, etc. The client purchases limited rights to use the photograph and to return the photo when the project is complete.

The firm is making a lease of the photograph to the client. The use tax is applicable to the lease receipts in this state of the property used by the lessee. Any amount received as royalty income is also includible in the taxable sales price of the lease. 4/19/93.

330.2770 **Royalties.** An artist receives royalties from companies which use her designs on posters, tee shirts, and other products but she retains the copyright to the designs. The designs are transferred to the companies either as an original artwork or as a slide. The original artwork is sent to the company which photographs it and returns the artwork to the artist. The company will later create a transparency from the slide it created. Slides are sent to the company which creates transparencies directly from the slides and then returns the slides directly to the artist.

The transfer of possession of tangible personal property, the slides and the original artwork, which is then returned to its owner, constitutes a lease of the property. A lease of original artwork is not a lease of property in substantially the same form as acquired by the lessor. The transfer of the original artwork is a taxable lease with the royalties received being the measure of tax. Assuming the artist paid sales tax reimbursement that was due on the purchase of the film processing which produced the slides, the transfer of the slides would not be a taxable transaction. In such case, the temporary transfer of the slides to the companies constitutes a lease of property in substantially the same form as acquired by the lessor. 6/2/89.

330.2789 **Sales at Inception.** A lease brokerage firm arranges financing for municipal lessees through various financial institutions. The brokerage firm often acts as lessor on a temporary basis, assigning its rights to the financial institution upon funding of the lease. All of the leases contain interim purchase options and a $1.00 buy-out at the end of the lease term.

A transaction of this type with a $1.00 buy-out at the end of the lease term is a sale at the inception of the lease in accordance with section 6006.3. The retail sale occurs when the property is delivered to the ''lessee.'' The retailer is the entity holding title at the time the property is delivered to the ''lessee'' and is responsible for payment of the sales tax. Any subsequent assignments to a financial institution would be considered an assignment of intangible rights and thus, not subject to tax. Also, no additional tax is due on the transaction upon the exercise of the buy-out options or termination of the lease. 11/13/86.

330.2790 **Sale at Inception.** A lease contains a clause requiring the lessee to purchase the leased equipment at fair market value at the end of the lease term or to find a buyer. The lease contract specifies the residual value of the property at the end of the lease term. If the option price paid by the lessee or the sale price paid by a third party (called the ''realized value'') is less than the residual value of the property, the lessee must pay the lessor the difference. If the ''realized value'' is more than the residual value, the lessor pays the lessee the difference. That is, the lessor always receives a total net payment equal to the residual value specified in the lease. Once the lease commences, the lessor never retakes possession of the property without there being a default by the lessee. Under these facts, the contract is a sale at inception. 4/12/90.

330.2791 **Sale of Leased Property Subject to Existing Leases.** Corporation A has purchased all of the assets from two corporations to which it is not related. The sellers produced a broad range of water products which they distributed primarily through a route delivery system in ½ to 5 gallon containers. They rented water coolers to many of their customers and made some sales of coolers to customers. The sellers primarily used two types of cooler rental agreements with customers. The first type is for rental on a month-to-month basis under a written agreement which included a provision requiring 30 days notice in order to cancel. The other type of rental agreement specified a minimum period of 12 months after which the rental converted to month-to-month with a 30 day cancellation provision. The sellers had purchased their coolers with tax paid on cost and tax was not charged on rental receipts. All coolers, with the exception of a minor amount held in inventory, were subject to existing leases on the date of sale of the business assets.

Other sources of revenue earned by the sellers included the rental of water filter and purification systems, an Office Refreshment Program which offered customers coffee, juice, refreshments and snacks, and the sale of paper cups to water cooler rental customers.

The sellers had California seller's permits as a result of their activities of making taxable sales under the Office Refreshment Program and sale of paper cups. Sales tax was reported and paid on sales of paper cups and other taxable sales, but the sales of bottled water were claimed as exempt.

Sales under the Office Refreshment Program appear to be related to the sellers' leases of water coolers and other related equipment. Their sales of the paper cups were clearly part of their business involving the leases of the water coolers. As a result of the activities in which the sellers were involved, they were required to hold, and did in fact hold, seller's permits. Since the sales were of assets used in the course of activities requiring the holding of those seller's permits, they were not occasional sales under section 6006.5(c).

With respect to the leases, all of the coolers were purchased by the selling companies with tax paid on cost. This means that corporation A purchased the coolers subject to leases which were not continuing sales. The sale to Corporation A is therefore a taxable retail sale, with tax measured by the sales price of the property to Corporation A. (Regulation 1660(c)(9)(A).) There is no election available to Corporation A. Tax is due on the sales price of the rental units to Corporation A. Neither the leases in effect at the time of the sale, nor any subsequent leases will be continuing sales. Therefore, the lease receipts will not be subject to tax. 5/30/96.

330.2792 **Sale of Leased Equipment.** A lessor sold leased equipment to a third party, subject to the lessee's rights under the lease, which included the lessee's purchase option right. If the lessee defaults on the lease, the original lessor will repurchase the equipment from the third party or will make the required lease payments. The original lessor argues that this is not a sale because the third party did not acquire any of the rights of ownership such as possession, right to sell or lease the equipment or risks of ownership and that the transaction was made in the form of a sale to obtain financing.

None of the arguments are valid. Pursuant to section 6006, a sale requires only passage of title or possession, not both. Although the new owner did not have the right to sell the property because of the lessee's rights, it did have the power to sell it subject to liability for damages to the lessee and the original lessor. Furthermore, a person structuring a transaction as a sale in order to derive the benefits in so calling it must accept the tax consequences which arise from so doing. 4/15/63.

330.2793 **Sale of Rental Units to Related Entity.** A lessor is in the business of leasing television converter boxes (units) which are taxable continuing sales in month to month leases. The lessor plans to sell the units to a related entity (corporation). The corporation wishes to pay tax on the purchase price of the units and then lease them without having to collect use tax on rentals payable. Also, it proposes to have the sale occur, retroactively, as of eight months back.

A person who purchases property subject to an existing lease is bound by the seller/lessor's tax treatment of that property. Thus, if the units are sold subject to existing taxable leases, those leases continue to be subject to use tax measured by rentals payable. However, if the lessor were to notify each lessee that his or her existing month to month lease agreement will be terminated as of a specific time and date (more than 30 days from date of notice to properly terminate month to month leases), then as of that time the units would no longer be subject to an existing lease. That notice could also inform each lessee that the unit he or she is currently leasing is being sold as of time and date specified in the lease termination notice and that the lessee's continued use of the unit after that time and date is acceptance of a new lease from the new owner. Under these circumstances, the corporation would not be regarded as purchasing the units subject to the existing leases. If such were the case and the corporation is regarded as purchasing the unit at fair market value as if at arms length, it would have the election to pay tax measured by the purchase price. The sale to the related party, however, will be disregarded for sales and use tax purposes if the sales price does not include all costs of the seller, including the cost of the property and any overhead properly allocated to the cost of that property.

The sale cannot be made retroactively. The determination of how tax applies to a transaction is based on the date the transaction occurs, not based on a retroactive date in the contract. 12/30/93; 4/7/94.

330.2795 **Sale at Termination of Lease.** There is no general exemption or exclusion under section 6010.65 with respect to a sale of leased property back to the lessee at the end of the lease term. 2/21/92.

330.2815 **Sales and Reacquisition of Rental Inventory.** A taxpayer is an equipment rental business. Some of its rental equipment was acquired ex-tax. The taxpayer now wishes to convert the ex-tax acquisitions to a tax paid status by selling the equipment to a nonrelated organization at fair market value and then to reacquire all or most of it and pay tax on the reacquisition price. The taxpayer's intent is to avoid tax on rental receipts.

The above plan would not be effective to avoid tax on rental payments. This transaction would be a sham if there were a written or oral understanding with the other organization that the taxpayer would reacquire the equipment. The substance of the transaction governs rather than the form. The substance would be that the taxpayer attempts to elect to pay tax on the purchase price of rental equipment after the time for making an election has passed. 1/14/77.

330.2820 **Sales of Rental Units to New Lessor.** A leasing company acquires the property it rents ex-tax and reports tax on the rental receipts. It proposes to sell its rental inventory to a related legal entity, at fair market value in an arms-length transaction. The purchaser will pay sales tax on the purchase price of the rental units. The purpose of the transaction is to put the rental units on a tax-paid basis and thereby eliminate the need to collect use tax on rental receipts. The seller/lessor will terminate the existing lease contracts, and the purchaser will enter into new leases with each lessee.

Provided the existing leases are terminated, the purchaser pays a fair market price for the rental units in an arms-length transaction, and also pays sales tax reimbursement to the seller/lessor, the purchaser's subsequent lease of the rental units will not constitute ''continuing sales and purchases.'' Therefore, no tax will be due on the rental receipts collected by the new purchaser/lessor. 3/30/90.

330.2825 **Sales Tax Paid to Nonpermitted Seller.** A lessor paid sales tax reimbursement on the purchase of equipment to a retailer who did not hold a ''seller's permit'' for equipment it leased.

Even though the retailer did not hold a ''seller's permit,'' the equipment leased will still be considered to have been purchased tax paid. There is no requirement in either Regulation 1660 or 1700 that the lessor prove that the retailer held a ''seller's permit'' or actually paid the tax to the Board, as long as the transaction was subject to sales tax. If the amount paid as ''sales tax reimbursement'' were actually use tax, the provisions of section 6202 would apply. 9/20/83.

330.2830 **Security Alarm Systems.** A company assembles and installs security alarm systems. After the system is installed, the company bills the customer an equipment charge and a labor charge. Thereafter, the company bills the customer quarterly for the security alarm system. For an additional fee which is billed separately, the customer may have the system monitored.

Under these facts, the company is leasing the security alarm system rather than providing a service. (Compare with Annotation 330.1920.) Since the system is not leased in substantially the same form as acquired by the company, the lease is a sale and is subject to use tax measured by rental receipts. The taxable rental receipts do not include charges for installation but include the initial equipment charge, charges for assembly or fabrication labor, and the quarterly charges.

The fee for monitoring the system is not taxable since this service is optional and not required in order to lease the system. 11/15/90.

330.2843 **Services/Deliveries in Conjunction with Rentals.** The following covers the application of tax to the leasing of oil well equipment and tools as well as servicing of such leased items:

(1) The lessor makes a separately stated charge for service personnel's visit to the customer's site pursuant to a tool lease agreement. The service personnel provide advisory service to assist the lessee in the proper utilization of the tools.

If such services are a mandatory condition to leasing the taxpayer's tools, the charges are taxable as services which are part of the sale (lease). On the other hand, if the customer is not required to acquire the taxpayer's services with the tools as a condition of his lease, tax would not apply to the charges for service.

(2) In delivering tools to the lessee by the service personnel, the taxpayer makes a mandatory separate round trip charge on the invoice.

The separate itemization on the invoice of a round trip mileage charge does not qualify for exclusion from the taxable measure as separately stated transportation charges. A round trip mileage charge will not suffice as a separately stated transportation charge since a portion of such charges is for the service personnel's return trip. Accordingly, such a charge is taxable even if the lease commences prior to transportation to the customers.

(3) As a condition of the lease, the lessee must pay for the first eight hour period or fraction thereof. This charge and the charge for ''additional periods'' and the ''misrun charges'' include the charge for the taxpayer's technical specialist.

The lessee's agreement is to pay these charges as a condition precedent to the lease of the tools and, accordingly, the charges are taxable. However, the ''call back or retrieving charge'' which applies if the technical specialist is released by the customer and later returns at the customer's request is an exempt charge for services. 10/29/82; 1/3/83.

330.2845 **Single Payment in Advance.** Under this type of lease, the lessee makes all lease payments in a lump-sum amount at the inception of the lease. Pursuant to Sales and Use Tax Law section 6457, the lessor must collect and report the use tax on all lease payments paid during the reporting period. This requirement is unaffected by the fact that the payments have not yet been ''earned.'' In the event of an early termination of the lease, if the lessee receives a refund of the lump sum rental payment pro rated on time not used versus total time originally contemplated by the lease, the Board will refund tax on such amount. 10/21/93.

330.2847 **Ski Equipment.** Rentals of skis for less than 24 hours and less than $20 by an operator located within two to three miles of five ski resorts would not qualify for the exclusion provided in section 6006.3, because the skis are used at the ski resorts which are not on the lessor's premises. 1/4/94.

330.2849 **Soap Dispensers.** A taxpayer is in the business of selling hand soap to hotels, car rental companies, and other businesses. The taxpayer also transfers dispensers for the soap to the customers since both the hand and laundry soaps cannot be used without a dispenser. The dispensers are provided to each customer along with the first load of soap.

The hand dispensers cost the taxpayer $3 each. A load of hand soap for the dispenser costs the taxpayer $28. A load of this soap is sold for $58.

The laundry dispensers cost the taxpayer $300 each. A load of laundry soap for the dispenser costs the taxpayer $25. The laundry soap is sold for $48.

The invoice for the first load states that the dispenser is ''lease only—no-charge—dispensers leased.'' Customers are not required to purchase additional soap after the first load. If they do, the taxpayer continues to charge $58 for the hand soap and $48 for the laundry soap. Invoices for reorder continue to use the ''lease only'' language.

The taxpayer claimed a depreciation deduction for the dispensers on its income tax return. Since there is a transfer of possession but not a transfer of title to the dispensers, there is a lease of the dispensers to the customer. The lease price is included in the charge for the soap. If the taxpayer reports the tax on the sale of

this first-load charge, no further tax is due. If the charge is exempt for any reason, tax is due on the receipts attributable to the lease of the dispenser. In the absence of any stated charge, the cost of the dispensers will be treated as lease receipts. 10/29/87.

330.2850 **Sound Tapes.** A lease of sound tapes by an out-of-state retailer engaged in business in this state to FCC licensed radio stations is a lease of tangible personal property. The lessee is liable for use tax measured by the sales price, and the retailer, being engaged in business in California, is required to collect the tax from the lessee and pay it to the state. The fact that the tapes may contain copyrighted works does not alter this conclusion. 12/3/90.

330.2870 **Sublease of Decorative Plants to Tenants.** The lessor of real property arranges for the lease of decorative plants to tenants. It adds a markup to the amount it pays to lease the plants. If the lessor pays use tax on its rentals from the plant owner, no further tax is due. 5/24/94.

330.2875 **Sublease of Fixtures Classified as Personal Property.** Fixtures classified as personal property under a prime lease retain their character for a sublease to a third person. A sublease is subject to all of the terms and conditions of the original lease. 11/7/75.

330.2877 **Sublease Out of State.** A prime lessor, who is a manufacturer, leases computer equipment to a California firm and charges use tax on the rentals. The California firm subleases the property to an Arizona firm and claims a tax paid purchase resold deduction. Since the California firm cannot change methods of reporting tax after the lease commences, no such deduction is allowable nor can a belated resale certificate be issued.

However, since a lease that is a continuing sale is subject to California use tax only for periods the property is inside this state, the lessor may file a claim for refund for periods the leased property was located outside California. 4/13/90.

330.2879 **Subleases.** In a series of subleases, where all the intervening subleases are sales for resale, and the rental receipts are the measure of tax, liability for collection of the tax rests only with the sublessor who leases the property to the consumer-lessee. If uncollectible at that point, one can then look only to the consumer-lessee. 12/5/74.

330.2880 **Subleases—Leased in Substantially the Same Form as Acquired.** When a lessor purchases property with tax paid on the purchase price and leases it in substantially the same form as acquired to a lessee who in turn subleases the property, the sublessor (first lessee) is not required to collect and pay tax on the rental receipts received under the sublease. A lessor may, however, purchase property under a valid resale certificate and collect and pay tax on his rental receipts, and his lessee likewise may give a valid resale certificate to the first lessor and pay tax on his receipts under a sublease. 8/18/65.

330.2885 **Subleases—Not Leased in Substantially the Same Form as Acquired.** Where the lessor manufactured the leased property, the lease of the property is a continuing sale, and there is no election available to pay tax on the purchase price. If such leased property is subsequently subleased prior to use by the lessee, the sublease is also a continuing sale if use tax is not paid measured by rentals payable under the prime lease. If use tax is paid on the prime lease, then the sublease is not regarded as a sale and the rentals payable from the sublease are not subject to use tax. 4/13/90.

330.2886 **Subleases—Tax on Rental Payments.** A lessor leases property in substantially the same form as acquired. At the time the property was acquired, the lessor paid tax or tax reimbursement as measured by the purchase price. This constituted an irrevocable election not to pay tax on rentals payable. Thereafter the lessor may not change its election by reporting tax on the rentals payable and claiming a tax-paid purchases resold deduction.

The same rule is applicable to subleases. When a lessee contracts to lease property and pays use tax to the lessor measured by the rentals payable, the lessee has made an irrevocable election not to pay tax on the rentals payable that result from a subsequent sublease. That is, the lessee/sublessor may not change its

election by reporting tax on the rentals it receives from the sublease by claiming a tax-paid purchases resold deduction on the rentals paid under the prime lease. Therefore, the lessee/sublessor must continue to pay tax on its rentals payable under the prime lease and the sublease is not taxable. 4/26/91.

330.2887 **Sublease—Without Collecting Use Tax Reimbursement from Sublessor.** A California bank purchased property without payment of sales tax reimbursement or without paying use tax, as measured by the purchase price of the property. The bank then leased the property to a sublessor who in turn, subleased the property to users. The sublessor did not tender a resale certificate to the bank; however, they did collect use tax from the sublessee's, as measured by the rental receipts.

Since the bank had not obtained a resale certificate from the sublessor, it voluntarily paid the Board an amount equal to the tax it would have owed, had the lease to the sublessor been a retail transaction. However, the bank did not reimburse itself for the tax it paid, by charging it to the sublessor.

Since the sublessor did not pay sales tax reimbursement or use tax, as measured by the purchase price of the property, the sublessor's lease of the property to the sublessee's were ''sales'' and ''purchases'' and subject to tax. The banks lease to sublessor was not taxable as it was a sale for resale. Accordingly, the bank is entitled to a refund of the amounts it (erroneously) paid to the Board. 7/13/84.

330.2888 **Sublessee Bound by Terms of Prime Lease.** A prime lease of car washing fixtures provides that the fixtures shall be personal property and that the lessor has the right of removal of the property. The lessee subleases the realty together with the car washing fixtures. The sublease does not contain the clause as to the fixtures remaining personal property. The provisions of a sublease are subservient to the provisions of the original if the terms are conflicting. The fixtures are by contract personal property in the hands of the lessee/sublessor. Thus they must remain so in the hands of the sublessee. Accordingly, the lease receipts are from leases of tangible personal property rather than leases of realty. Tax, if any, applies in accordance with Regulation 1660. 11/7/75.

330.2888.250 **Sublicense of Software.** A taxpayer obtains canned software from its lessor under a licensing agreement which that taxpayer will sublicense to its customer. The lease agreement requires a primary license charge plus annual license charges. Under the terms of the licensing agreement, if the annual license charge is not paid, the taxpayer must discontinue use of the product and return all copies to the lessor.

If the taxpayer transfers to its customer the actual software it obtains from the lessor and if the agreement requires that actual software be returned if the license fee is not paid, the transfer to the customer is a sublease under Regulation 1660(c)(5). The sublease is subject to use tax measured by the subrental payments unless the taxpayer makes a timely election to pay its lessor use tax measured by the rentals payable under the prime lease. (See Annotation 330.2170.)

If, however, the taxpayer were to retain the original media which it receives from the lessor and make a copy for lease to its customer, the taxpayer would be using the software obtained from the lessor and not leasing it. As a result, the transfer to the taxpayer of the original media would be a taxable retail sale under section 6006(g)(5) and the taxpayer's transfer of the copy to its customer would also be taxable because the software transferred to the customer would not be the same media that the lessor acquired from the taxpayer. 6/22/95.

330.2889 **Supervision by Lessor.** In order for the owner of equipment to be regarded as providing services rather than leasing the equipment, the owner must not only furnish and supervise the use of the equipment, he or she must actually operate the equipment. Thus, the furnishing of oil drilling equipment which is operated by the customer's employees is a lease notwithstanding that supervision is provided by the seller. 12/28/70.

330.2890 **Tape Recorded Music Furnished for Reproduction on Customer's Tapes.** An owner of tape recorded music who has not paid tax or tax reimbursement on the finished tapes at the time he acquired them makes a taxable lease of the tapes and the measure of tax includes charges for a license to use the

music where he furnishes the tapes to a customer or to a sound laboratory at the direction of the customer with the understanding that the sound laboratory will record the music on tapes furnished by the customer and bill him accordingly, that the original tapes will then be returned to the owner, and that the owner will charge the customer for a license to use the music.

The same result follows where the owner rents the tapes to a customer for a specified, annual charge and then charges him also for a license to use the music when and if such use is made.

The charges by the sound laboratory are also subject to tax. 11/12/74.

330.2920 **Tax-Paid Acquisition by Stockholders of Lessor Corporation.** A corporation formed by doctors who exchanged their equipment for capital stock of the corporation is required to collect tax measured by rental receipts from the doctors leasing the equipment from the corporation, although the doctors paid the sales tax on the original purchase of the equipment, because the corporation has a distinct personality from that of the individual doctor and after the transfer of the equipment to the corporation by the doctors, the corporation became the lessor of the equipment. The doctors paid the sales tax on the equipment prior to its transfer to the corporation, no tax was paid by the corporation to the doctors, and only lessors who have paid sales tax may lease property tax-free. 12/15/69.

330.2940 **Tax-Paid Acquisition—Subsequent Statutory Merger.** Property upon which a corporation has made a timely payment of sales tax reimbursement or use tax measured by the purchase price, thereby qualifying the rental of the property in its purchased form for exclusion from classification as a leasing sale, retains its exempt status when the corporation is merged with another corporation in the manner prescribed for a statutory merger under California law. By operation of law, the existence of the merged corporation is continued as a part of the surviving corporation with all of the rights and obligations which it previously held. 8/14/69.

330.2955 **Tax Paid on Cost and Rentals Payable.** When property is leased in the same form as acquired and tax was mistakenly paid both on cost and on rentals payable in a timely manner, the first payment of tax will determine the election to report tax measured by cost or by rentals payable. If tax was first paid measured by cost, then rental receipts are not subject to tax in accordance with Regulation 1660(c)(3). On the other hand, if tax was first paid on rental receipts, the tax paid on cost is subject to refund. 4/15/91.

330.2958 **Tax Paid on Less than Full Sales Price.** A person purchases property outside the state from a retailer who is authorized to collect California use tax. The buyer intends to lease the property in California. Through an error by the seller in interpreting the application of tax to fabrication labor, use tax was paid to the seller upon approximately 90% of the taxable charge. Because it was clear that the buyer intended to buy the property tax-paid for the purpose of leasing it ex-tax and because the amount of tax actually paid closely approximates the amount due, the property should be regarded as tax-paid for purposes of leasing. The buyer remains liable for the difference between the amount of tax paid and the amount of tax due. 4/14/81.

330.2960 **Tax-Paid Property—Lease of.** If tax has been paid by a lessor on the full purchase price of the property consisting of the cost of materials and outside fabrication labor, no tax is due on the rental receipts from the leasing of the property. 8/6/65.

330.2965 **Tax-Paid Purchase Resold Deduction—Lease Property.** A lessor who purchases property tax paid at source which is not being leased in substantially the same form as acquired must pay tax on its rental receipts. However, the lessor may take a tax-paid purchases resold deduction on their return for the reporting period during which the property is first leased, provided the lessor made no use of the property prior to the lease. For past reporting periods for which a return has been filed, the lessor must file a claim for refund. 1/16/91.

330.2968 **Tax-Paid Status of Leased Equipment.** A lessor of equipment sells the equipment together with the existing lease to a purchaser. The equipment was purchased tax-paid by the lessor and lease

receipts were not subject to tax. The lessor (seller) pays the sales tax on the sales price to the Board, but does not charge the sales tax reimbursement nor obtain tax reimbursement from the purchaser.

The sale of tax-paid property subject to an existing lease is a retail sale with no option to purchase the equipment for resale since the existing lease is not a continuing sale. Since the seller properly paid sales tax to the Board on its sale, no further tax is due on the transaction between the seller and the purchaser. However, since the purchaser (new lessor) did not pay sales tax reimbursement on the purchase price, any future leases of the equipment would be taxable continuing sales. 8/29/96.

330.2969 **Tax-Paid Status of Leased Property Changed.** A partnership, consisting of two brothers ,A and B, was a road construction contractor who from time to time rented construction equipment which the partnership owned. The partnership also held a 50% ownership in a batch plant with individual C who held a 50% ownership.

Both the construction equipment and the batch plant were purchased tax paid. In 1960 brother B died and his widow inherited his interest in the partnership. Title to the construction equipment was then held by a partnership which was formed consisting of A and the widow of B. On January 7, 1966, the widow of B sold her interest in the construction equipment to A without payment of tax; A then held title to the construction equipment as an individual.

Also, after B's death, title to the batch plant was held by the partnership formed by A and the widow of B (50%) and by C (50%) as an individual. In 1965, C sold its 50% interest to D, an individual. This was a taxable transfer and tax was reported and paid. Title to the batch plant was now held by a partnership consisting of A and the widow of B (50%) and D as an individual (50%). A, the widow of B, and D formed a partnership and their interests in the partnership were the same as their ownership interests in the batch plant. The batch plant was used in the partnership and also rented to third parties, but it was not contributed to the partnership, i.e., title did not pass to this new partnership but continued to be held in joint ownership.

On January 7, 1966, the widow of B sold her interest in the batch plant to A, ex-tax. Since that time the batch plant has been owned by A (50%) and D (50%) as individuals; each carries his 50% interest on his personal books.

In applying the Sales and Use Tax Law, a partnership generally is viewed as a distinct entity. Therefore, when title to property is transferred from the partnership to another partnership or to an individual, that new partnership or that individual becomes the ''lessor.'' This new ''lessor'' must pay the tax on its purchase price, or have acquired the property from a ''transferor'' who paid the tax, or collect tax on rental receipts.

In the case of the construction equipment, when B died, that partnership dissolved by operation of law (Corporation Code section 1503.1). The property was then held by A as an individual and widow of B as an individual, and was thereafter contributed by them to a new partnership, a new entity consisting of these two individuals. The construction equipment became partnership property at that time (Corporation Code section 15008) and the partnership was the ''lessor'' of the property thereafter. When widow of B sold her interest to A, their partnership ceased to exist, and A became the ''lessor'' of the equipment. Therefore, since A does not meet the terms of Regulation 1660(c)(4), all rental receipts on the construction equipment received by A are subject to tax.

The same analysis is applicable to the 50% interest now held by A in the batch plant. However, 50% of the plant was purchased tax paid by D and he has continually held that portion in his ownership. D is the lessor as to that half, and the rental receipts attributable to it are not subject to tax. 7/14/70.

330.2980 **Telephone Charges.** Service charges for ordinary telephone services and for ''leased lines'' for telephone or teletype service are not charges for leasing of tangible personal property. 12/31/65.

330.2988 **Temporary Power Poles.** A firm furnishes poles and wiring, hooks them into the power grid of a utility, and installs the poles by imbedding them in the ground at construction sites. A single separate

charge is made for delivery, installation, and removal. Most leases are for periods of 60–90 days with a few for 3 to 6 months. The utilities place no time limit on how long the poles may be in place.

The lease is a lease of real property. Under section 6016.5, power poles are excluded from the definition of tangible personal property. Additionally, the poles are attached to the realty and are intended to remain for whatever time is necessary to accomplish the lessee's purpose and, thus, are improvements to realty. 12/22/89.

330.3010 **Transferee's Lease of Property.** The fact that a transferor was not required to hold a seller's permit does not preclude his transferee's subsequent rental of the property from qualifying for the leasing sale exclusion provided by Revenue and Taxation Code section 6006(g)(5)(A). Under this provision of the law the transferee retains the tax status previously enjoyed by the transferor if the rental property transferred represented all or substantially all of the assets held in the transferor's business activity and the real or ultimate ownership after the transfer was substantially similar to that which existed before such transfer. 1/7/71.

330.3011 **Transfer of Names and Addresses by Magnetic Tape.** A company makes two copies of an owner's mailing list tape and then returns the original tape to the owner.

The use of the original tape to make copies is an exercise of dominion and control over the tape by the company. Since the company is not processing information for the list owner and no output resulting from the processing is transferred to the list owner in human readable form, or in any other form, Regulation 1502 is not relevant to this situation. The transfer of names and addresses by means of magnetic tape constitutes a lease of the tape. The transfer of a mailing list tape is not considered to involve only a transfer of intangible information.

The ''one time only'' restriction is contained only in the contract between the company and its customer, not between the company and the mailing list owner. The fact that the company agrees with the list owner to restrict the company's customer to a ''one time only'' use does not restrict the company to a one time use. The fact that the company must get the list owner's approval of each mailing is not a numerical restriction but goes to the list owner not wanting to undercut his own purposes by allowing mailings to be made by potential competitors. The ''one time only'' restriction is not applicable to this situation. The lease is subject to tax. 10/19/76.

330.3011.200 **Transfer of Real Estate Information on Disks.** A taxpayer is in the business of providing commercial real estate information to its customers through a license agreement. The taxpayer maintains a database of commercial real estate information for certain geographic regions which is updated daily. The taxpayer compiles this information on computer disks and CD ROMs which it provides to customers on a temporary basis.

Where a transaction involves the delivery of tangible property which includes information generated from a pre-existing database, the transaction is a sale or a lease of tangible personal property and is subject to tax unless an exemption otherwise applies. Since the taxpayer is providing its numerous customers with noncustomized information on computer disk and CD ROM at a standardized price, the true object sought by the taxpayer's customers is regarded to be the disks and CD ROMs for the information contained in those items and not the providing of a service by the taxpayer. Therefore, the taxpayer is leasing disks and CD ROMs to its customers which are not in substantially the same form as acquired. The taxpayer must collect tax on the rentals payable for its disks and CD ROMs and remit these amounts to the Board. 10/8/96.

330.3012 **True Lease vs. Outright Sale.** When the only basis for regarding a transaction structured as a lease, as a true lease and not a sale under a security agreement, is the right of the lessee to terminate the contract, that termination right must be within the control of the lessee. If the lessee's only right to terminate is based on the actions or inaction's of the lessor, such as a material breach of contract or warranty, the agreement will be regarded as an outright sale under a security agreement. Such a termination

provision alone, leaves the control with the lessor and thus the lessee must be regarded as bound for a fixed term within the meaning of section 6006.3. 6/28/94.

330.3015 **Tuxedos.** Single use leases of tuxedos and similar garments are not rentals of linen supplies and similar articles in which the recurring service of laundering or cleaning is an essential part of the lease within the meaning of subdivision (g)(2) of section 6006 of the Revenue and Taxation Code. There is no recurring cleaning for a single use lessee. Such leases are continuing sales subject to tax on the lease receipts unless the lessor makes a timely election to pay sales tax reimbursement or use tax. 8/20/80.

330.3017 **Tuxedos—Alteration Charges.** Alteration charges in connection with rentals of tuxedos are included in the measure of tax for rentals. These alteration charges are charges necessary for lessees to rent tuxedos in the form desired. 11/28/88.

330.3019 **Tuxedos—Rentals through Franchise and Bridal Stores.** In addition to providing rental tuxedos to its corporate stores, a taxpayer provides tuxedos to franchise and bridal stores. All locations use identical rental tickets with the name of the taxpayer's company. The only distinction between tickets is the store address listed. Rental prices and policies were established by the taxpayer and were identical at all locations. The orders were made on the taxpayer's forms. The franchise and bridal stores telephone orders to the taxpayer's warehouse and the taxpayer delivers and picks up the tuxedos. The franchise and bridal stores have their own employees. They collect the rental receipts and deposit them in their bank accounts. The franchise and bridal stores receive a flat 35 percent to 50 percent commission. All stores, except for bridal stores, use almost identical window displays and signs. (There is much less tuxedo paraphernalia in bridal stores because tuxedo rentals are not the majority of the business.) Radio and print advertising do not make a distinction between corporate, franchise, or bridal store locations and stress the total number of locations available.

The taxpayer does not pay sales tax reimbursement or use tax on the purchase price of the tuxedos, nor is any use tax collected on rentals payable. Since tax was not paid on the purchase price, the leases are taxable. The remaining question is whether the franchise and bridal stores are leasing the tuxedos to the customers or if instead those stores act as the taxpayer's agents in facilitating the taxpayer's leases to the customers.

Under the facts here, there is but a single lease transaction, recorded on a single form, with the taxpayer never relinquishing control of the tuxedos. There is never a separate lease to the stores followed by the stores' sublease to the customers. The taxpayer was leasing the tuxedos to the customers and the franchise/bridal stores were acting as the taxpayer's agents. Thus, the taxpayer owed the amount of tax it was required to collect on rentals payable. 6/8/95.

330.3040 **Use Tax.** Except in the cases of leases to the United States Government, to banks, or to insurance companies, the lessee is liable for payment of the use tax on the lease payments which the lessor is required to collect from the lessee at the time rentals are paid by the lessee under the lease. Whether or not the amount of the tax is separately stated in the lease document would be immaterial. The lessee is under a legal liability for the tax in any event. 8/5/65.

330.3042 **Use Tax—Collection by Lessor.** Section 6205 prohibits any lessor from advertising in any way that the use tax will not be added to the rental amount due from the lease or rental of tangible personal property which was acquired in a manner causing the rental to be defined as a sale. There is no similar prohibition regarding the noncollection of sales tax reimbursement. 3/4/94.

330.3060 **Use Tax Refund.** A lessor who purchased house trailers ex-tax and placed them in rental service and elected to report his use tax liability measured by his purchase price is not entitled to a refund of use tax when he returned the property to the seller, since he had incurred use tax liability when he first placed the property in rental service. 4/15/68.

330.3071 **Use by Lessor in California After Out-of-State Lease.** A lessor leases tangible personal property to an out-of-state lessee. The property was not purchased tax-paid by the lessor. After termination

of the lease, the lessor brings the property back to California for utilization in the lessor's own operations in California.

If the property was not within the state prior to the out-of-state lease and did not enter the state within 90 days of the start of the out-of-state lease, the subsequent use of the property in this state by the lessor is not subject to tax. If the property was in the lessor's inventory in California prior to the out-of-state lease and did not re-enter California until more than six months from the start of the lease, the subsequent use of the property in this state by the lessor is also not subject to tax pursuant to section 6009.1. If neither of these conditions is applicable, the subsequent use in this state is subject to tax. 3/17/80.

330.3073 **Vehicles Registered in Name of Lessee Only.** The tax liability of a lease may not be measured by rental receipts if the vehicle is registered only in the name of the lessee. This type of registration misrepresents the ownership of the vehicle, and allows for a sale of the vehicle to the lessee without the necessity of changing the registration and alerting DMV to the possible use tax liability related to the transfer. In such a case, the tax is due on the selling price of the vehicle to the lessor. If the lessor is also a licensed dealer, the tax is measured by the cost of the vehicle to the dealer/lessor. However, Regulation 1610(d) allows for the correction of an erroneous lessee registration. If the registration is corrected, the rental receipts method may be continued. 10/21/93.

330.3075 **Video Cassettes, Tapes and Discs.** The lease of video cassettes, tapes or discs to libraries, churches, schools and business to exhibit to their respective patrons, congregations, students and customers is not a sale pursuant to section 6006(g)(1). The exception provided by section 6006(g)(7) does not apply because the lessee obtains the right to ''exhibit'' the video cassette. The lessor is the consumer of the video cassette. 12/20/90.

330.3078 **Video Rental Coupons.** A taxpayer who is in the business of renting video tapes will sell ABC Co. 25,000 coupons at a total price of $62,500 (25,000 coupons at $2.50 each). These coupons entitle the holder to a free video cassette rental at any of the taxpayer's stores and will be distributed at no charge by ABC Co. to its customers. ABC Co.'s customers will then present these coupons at a taxpayer's store for the rental of a video cassette.

Under these facts, the taxpayer is regarded as selling nontaxable rights to free video cassette rentals to ABC Co. The actual coupons are a record of the rights to the free rentals and do not constitute the sale of tangible personal property. ABC Co.'s distribution of these coupons to its customers also is regarded as the use of intangible property. As such, no tax applies on either the taxpayer's sale of these coupons or on ABC Co.'s gift of these coupons to its customers.

However, rental of these video cassettes is a continuing sale and purchase and tax applies measured by the rental receipts. (Regulation 1660(d)(2).) The tax imposed on this type of lease is a use tax on the lessee, and the taxpayer, as lessor of the video cassettes, is responsible to collect the tax from the lessee. (Regulation 1660 (c)(1).) In this case, the taxpayer is renting video cassette tapes to customers who present a coupon for a ''free'' rental. Since the taxpayer will have received compensation from the ABC Co. for the rental of its video tapes via amounts paid by ABC Co. for coupons, the rental receipts of the video tapes will consist of the $2.50 received from the ABC Co. for that customer's coupon. Tax on this amount is imposed on the lessee (the person presenting the coupon) and the taxpayer is required to collect this tax and remit it to the state. The tax does not apply on the amounts the taxpayer received on its sale of ''free'' coupons which are not redeemed. 8/17/95.

330.3080 **Water Softener Units.** Persons using water softener units which are attached to the homeowner's water supply plumbing are renting those units rather than rendering a service to the homeowner regardless of who services the units. 6/19/69.

330.3095 **Waste Water Filtering System—Rental vs. Service.** In determining whether providing a water filtration system is a lease of tangible personal property or the rendering of an exempt service, the decisive factor is the true object sought by the customer. The true object test was applied in *Culligan Water Conditioning* v. *State Board of Equalization* (1976) 17 C.3d 86. In its decision, the court said that the chief

characteristic of a lease is the giving up of possession by the owner so that the customer uses and controls the rented property. In regard to water filtration systems, the customer controls the use of the system by determining when and how much water passes through the system. These factors also control how often the filtration elements or materials have to be replaced. The replacement activities were the only recognizable ‘‘services’’ provided in the contract. The court thus concluded that the true object was obtaining a properly generated and efficiently functioning water conditioning unit. These same principles that apply to water softening systems apply equally to a system for the removal of pollutants from waste water.

Therefore, the object of the contract is for use of the filtering system and not for the service the taxpayer provides by replacing the spent carbon. The customers seek tangible personal property and the taxpayer provides tangible personal property under a lease of tangible personal property to its customers. 10/6/93.

330.3100 **Water Softener Units.** The lease of a residential water softening unit, attached to the plumbing system by the leasing company, is not converted into an exempt service agreement because the units are periodically exchanged by the lessor and the homeowner does not have occasion to manipulate the unit. 11/8/68.

330.3120 **X-Ray Machines.** An X-ray laboratory leasing an X-ray machine from the owner is not a sublessor when the laboratory uses the machine in rendering services to its clients. It is the owner leasing the machine that is required to pay tax on the rental receipts collected unless the equipment was acquired for rental purposes in substantially the same form as that in which it is leased. In this instance sales tax reimbursement or use tax measured by the purchase price of the machine must be paid. 8/4/65.

330.3121 **Lease of Instruction Material.** A firm offers various instructional courses to school graduates to prepare them for future examinations and furnishes written materials to its students in connection with some of these courses. The contract provides that these materials are leased to the students for use only while taking the course and that the materials must be returned on or before a certain date. Failure to return the materials by the specified date is deemed an election to extend the lease at a specified rate per month.A1973 contract offered students an option to lease the materials alone without purchasing any instructional services. If the student contracted to lease materials and purchase instructional services but canceled the contract after possessing the materials for five or more days, the student agreed to be liable for the ‘‘materials only’’ option. A 1974 contract did not offer a ‘‘materials’’ option but did provide that if the students canceled the contract after possessing the course materials for five days or more, the student would be liable for a specified amount as the cost of using the materials. The firm believes that the lease prices do not reflect the actual value of the course materials and believes the taxable measure should only be the cost of compiling the materials.

It is concluded that the firm is leasing the materials to its students. Even if the firm destroys the materials after they are returned, it does not alter this conclusion. In view of the contract provisions for 1973, it is also concluded that when a student canceled the contract, the measure of tax is the amount of the ‘‘materials only’’ option. Although the specified amount was higher for the 1974 contracts, this amount is the measure of tax for the 1974 leases. The measure of tax for a lease which is a sale is the rentals payable, not the fair market value of the leased property. The firm chose to lease the materials rather than transfer title in order to insure that the materials would be returned and destroyed. Both the 1973 and 1974 contracts specified the portion of the total charge which was attributable to the lease of materials and these contracts were entered into by the parties in arm’s length transactions. For these reasons, although the agreed lease price may have been high, there is no basis for using the cost of the materials as the measure of tax. 10/27/77.

330.3128 **Lessee—Credit for Tax Paid to Texas.** A lessee entered into a lease of a vehicle in Texas and thereafter moved to California, bringing the vehicle with him. The lease contract showed an amount of $3,147.38 in ‘‘rental tax’’ paid to the state of Texas.

In Texas the tax is imposed on the lessor although the lessee may end up bearing the ultimate economic burden. In California, the use tax is imposed on the lessee. Since the tax is imposed on a different person (the lessor), the section 6406 credit is not available to the lessee. Furthermore, the section 6406 credit is not

allowed against taxes measured by the periodic payments due under a lease to the extent that the taxes imposed by the other state were also measured by periodic payments made under the lease for a period prior to the use of the property in this state.

Accordingly, the lease of the vehicle is subject to California use tax for periods in which the vehicle is in this state. 3/16/95.

330.3130 **Lessor/Lessee Merger.** Taxpayer A merged with Taxpayer B in a tax free statutory merger. Before the merger, Taxpayer B had been paying tax on its lease payments of various pieces of equipment leased from Taxpayer A. After the merger, the resulting corporation used the equipment internally. On some assets, the tax paid on the lease receipts exceeded the tax due on the purchase price method. On other assets, the sales tax due calculated and remitted using the rental payment method is less than the tax that will be due under the purchase price method.

The company asks whether it can calculate an aggregate tax due and then pay the net tax due for all equipment or if it can use the credit for tax previously paid under the rental payment method on one item of property to reduce the tax liability on the purchase price of another item of property.

Tax may not be reported by either of these proposed methods. Tax is calculated with respect to each transaction involving a sale of tangible personal property on an item by item basis. After the merger, the lessor and lessee became one entity, which means that the property that had been leased by the lessor to the lessee is thereafter used by the surviving corporation. The surviving corporation owes use tax measured by the purchase price of the property. It is irrelevant that on some of the assets the tax collected by Taxpayer A, which was collected and paid under the rentals payable method, exceeds the tax that would have been due under the purchase price method for calculating tax since such ''excess'' amounts are not overpayments and cannot be refunded. On those assets for which the measure of tax paid on the rentals is less than the tax due on the purchase price, the tax will be due on the difference. 1/13/93; 10/8/93.

330.3160 **Records to Show Rented Property Is Tax-Paid.** Although Sales and Use Tax Regulation 1698 authorizes the destruction of records after four years, that does not apply to records needed to show that rented property was purchased tax-paid. It is the taxpayer's burden to show that tax does not apply to current rental receipts. 2/25/75.

330.3161 **Related Entities.** Company A proposes to lease vehicles which it purchases ex-tax to a related corporation B. B in turn will lease the vehicles to third parties. A proposes to report tax on its rentals to B, thus making B's rentals nontaxable.

The rental agreement between A and B will be recognized as a valid lease provided that the lease is at a price calculated not only to return the wholesale cost but also at least to cover the ordinary and necessary business expenses from the transaction. 8/25/86.

330.3165 **Subleasing—Tax Liability.** Manufacturer A leases equipment to B leasing company who subleases to C, the consumer. No tax has been paid to the state in connection with any of these transactions. All parties are located in California.

The prime lessor, A, has ''prime liability'' for any tax due on the lease, i.e., A should be looked to first for payment to the state. If tax is uncollectible from A, the next person in the chain should be looked to and so on to the ultimate lessee, provided resale certificates have not been presented.

The tax on rentals is a use tax on the lessee. (Section 6202.) Therefore, the prime legal liability is on the consumer who must pay the tax to the lessor. However, section 6203 requires the lessor to collect the tax from the lessee at the time amounts are paid by the lessee under the lease. Section 6241 provides further that it shall be presumed that property sold for delivery in this state is sold for storage, use, or other consumption in this state (i.e., that tax is due and must be collected by the retailer until the contrary is established). The burden of proof is on the retailer unless he accepts a resale certificate. From this, it is concluded that ''primary liability'' for tax due is on the prime lessor, in this case A. At the same time, the

purchaser-lessee remains liable for the tax imposed on him by section 6202 until he can show that: (1) tax has been paid to the holder of a valid seller's permit or Certificate of Registration—Use Tax through presentation of the receipt required by Regulation 1685, (2) tax has been paid on rental receipts of the prime lessor or other prior sublessor, or (3) a basis for exemption otherwise exists. Thus, the prime lessee would be looked to next for the tax.

When A leases to B, and B states the intention not to sublease, the correct procedure is for A to collect tax from B and remit it to the state.

However, once A can establish a sublease, A is relieved from his responsibility to collect and remit tax on the transaction. The tax is then due from B or if it cannot be collected from B, from C.

In summary, the Board can assess a deficiency against anyone in the chain. The burden is then upon them to establish the contrary. 11/20/68.

330.3167 **Vehicle Modified for Use to Transport Handicapped Persons.** A leasing company leases and sells vehicles to a firm (Corporation) engaged in the business of transporting handicapped persons. After the purchase and prior to the lease and sale, the leasing company modified these vehicles to accommodate the needs of the handicapped persons.

Under subdivision (a) of section 6369.4, an exemption from sales and use measured by the gross receipts of materials purchased or used to modify a vehicle to accommodate handicapped persons is only available at the time the modifications are performed. If there is a subsequent sale or resale of the vehicle after the modifications have been performed, the exemption is available for the portion of the sales price attributable to the modifications **only if** the purchaser of the vehicle is a disabled person eligible to be issued a license plate or placard for parking privileges accorded to disabled persons pursuant to section 22511.5 of the Vehicle Code. Since the transportation firm, as a corporation entity, cannot be considered a ''disabled person who is eligible to be issued a distinguishing plate or placard,'' the transfer of the vehicles to the corporation do not qualify for the exemption. 6/24/97.

330.3168 **Wind Power Facilities.** A firm enters into a construction contract with an investor to build a wind power facility. The wind power facility is constructed on property leased by the firm from a third party and subleased to the investor. The owner of the wind power facility (the sublessee of the land) leases the wind power facility to a lessee together with its interest in the real property.

The components of the supporting tower of the wind facility are ''materials'' and the wind turbine head is a ''fixture.'' Accordingly, the contractor is the consumer of the components of the supporting tower and the retailer of the wind turbine head.

Since section 6016.3 excludes from the definition of tangible personal property leased fixtures when the lessee is also the lessee of the land, the lease of the wind turbine facility is not a lease of tangible personal property. The concept is equally applicable to situations in which the parties involved are sublessors and sublessees.

Under the above circumstances, the contractor is subject to tax on materials and fixtures, and the lease is a lease of real property. 11/4/86.

(b) RENTAL RECEIPTS—ITEMS INCLUDED AND EXCLUDED

330.3172 **Alterations to Leased Garments.** A lessor of garments who has elected to report tax liability on rental receipts must include, as rental receipts, any charges made to lessees for alterations, regardless of whether the garments are new or used. The lease implicitly is for garments that fit the lessee, making the alteration charge an amount required by the lease. If the lessor timely elected to pay tax on the purchase price of the garments, neither the rentals nor the alterations are subject to tax, regardless of whether the garments are new or used. (Also see Annotation 330.4180.) 3/2/94.

330.3174 **Auto Leases—Specific Fees.** A lessor of autos on which tax is being reported based on lease receipts makes the following fee charges in connection with such leases.

(1) A lessor wishes to change the due date on lease payments. The due date is changed free of charge the first time. Any changes after the first time result in a fee based on the value of the car and the extension length.

(2) If the lease is assumed by a third party, a $250 fee is charged to cover the cost of credit reports, credit approval, correcting title and other such costs.

(3) The lessee did not purchase an ''insurance proceeds deficiency liability release'' at the time of the initial lease. A couple of months after the lease is signed the lessor will offer an ''Optional GAP Waiver Agreement'' for a fee of $400 to $500 to cover certain contingent liabilities under the lease.

With respect to the due date change fee and the assumption fee, both of these fees are required under the lease and are included in the rentals payable and tax applies to these charges. The separately stated waiver fee is optional and not required by the lease and therefore is not subject to tax. 4/30/97.

330.3176 **Booking Agent Fees.** A rental car company (lessor) operating in California has established a separate legal entity to act as a booking agent for renting cars. The lessor's rentals are continuing sales and purchases subject to use tax measured by rentals payable. The booking agent represents only the lessor, and does not arrange bookings for other rental car companies or other forms of transportation.

The booking agent negotiates a reduced rental rate with the lessor on behalf of the lessee. The subsequent rental transaction is between the lessor and lessee, with the lessee paying the agreed amount plus applicable taxes directly to the lessor. The booking agent separately bills the lessee a fee for negotiating the reduced rate with the lessor. The booking fee is 20–25% of the amount which the lessee pays to the lessor for the car rental.

The booking agent fee is part of the rental receipts of the lessor, and is subject to tax. The lessor cannot decrease the measure of tax on its rentals by establishing a separate legal entity to perform part of the administrative functions of their rental business and then separately stating a fee for this function and requiring the lessee to pay the fee to a separate entity. 7/31/97. (M98–3).

330.3177 **Budgeted Maintenance and Control Agreement.** Company A leases certain vehicles from Company B. The basic Fleet Lease Agreement requires Company A (the lessee) to maintain the vehicles. However, the majority of the vehicles being leased are under an optional maintenance ''cost reporting program.'' In these instances, A has elected to receive monthly cost reports and, in addition to the basic monthly rental charge under the Fleet Lease Agreement, A pays a $20 maintenance reserve deposit per vehicle and a $2 per month management fee per vehicle. The $2 monthly fee represents a current and unrecoverable expense for A. The $20 monthly payment represents an asset on A's books and a liability on B's books. When it becomes necessary to repair a vehicle, the custodian issues the repairer a purchase order in B's name. The repairer bills B who, in turn, pays the bill and reduces A's deposit account by a like amount. Should the garage bill exceed the balance in the account, B will request an additional payment from A for the difference. At the expiration of the lease, any unused deposit balance will be returned to A by B. Likewise, should the deposit account reflect a negative balance, A would issue a check to B in that amount.

Neither the maintenance payments (initial, monthly, and additional) nor the management fees are subject to tax. The Maintenance Agreement is not in conflict with the Fleet Lease Agreement. A has undertaken to maintain the vehicles. A contracts for maintenance directly with the local service stations and, consequently, A is legally responsible to the servicing organizations for payment on work done. The maintenance payments and management fee paid under the Optional Maintenance Agreement are not payments made to B in reimbursement for expenses incurred by B under the Fleet Lease Agreement. Such payments do not constitute taxable lease receipts. The application of tax to charges by the repairer are governed by Regulation 1546. 7/21/77.

330.3180 **Car Rental Drop-Off Fees.** The ‘‘drop-off’’ charge for returning a rented car to a location other than that at which the car was rented constitutes part of the rentals subject to tax. 1/10/68.

330.3190 **Charge-Back to Lessee for Repairs.** Taxable rentals exclude a charge-back to the lessee for the repair and reconditioning of a vehicle, when the lessee has the option to make the necessary repairs elsewhere, prior to the return of the vehicle at the end of the lease. Such fees are considered costs incurred in disposing the property at the expiration or earlier termination of the lease. 4/17/90.

330.3194 **Charges Under Leases.** A taxpayer leases automobiles and makes the following charges:

(1) Excess mileage fee: assessed for excess miles driven by lessee over a predetermined standard.

(2) Renegotiation fee: assessed at the time the lessee signs a new lease agreement covering the same vehicle under a prior agreement. This is a flat rate documentation fee.

(3) Documentation fee: assessed at the time the lease is signed as a fee for processing the lease.

(4) Assumption fee: assessed if the lease is assigned by the lessee to another party.

(5) Deferral fee: assessed if lessee wishes to extend the lease for a short period of time without signing a new lease agreement.

(6) Late charges: assessed for failure to return the vehicle timely upon termination of the lease.

These are all payments required by the lease. Therefore, these charges are subject to tax.

A payment made by the lessee for failing to return the vehicle when due is a charge for use of the vehicle and also is subject to tax. 2/5/87.

330.3200 **Copying Charges.** ‘‘Per copy’’ charges required by the copy machine rental agreement will be considered receipts from the transfer of tangible personal property rather than rental payments, if they are fairly attributed to the transfer of copy paper supplied by the lessor. In those instances, the lessee may give the lessor a resale certificate for those charges when he sells his copies in the regular course of business.

Conversely, ‘‘per copy’’ charges must be included in the measure of rental payments when those charges measure the use of the copier, and different charges are made for paper supplied by the lessor. A lessor should not accept a resale certificate which is applicable to only those ‘‘per copy’’ charges. 1/27/66.

330.3225 **Damage Charges.** Payments made by a lessee for damages to equipment resulting from improper use or abuse of the equipment are not part of taxable rental charges.

Also, the amount paid by the lessor with respect to the cost of parts used in repairing the damage in question is not taxable. Following the repair of the damage, the parts become incorporated into the leased item. The fact that tax is paid on the rental receipts negates the requirement of paying tax on any component of the unit. 2/11/75.

330.3230 **Damaged or Missing Equipment.** Compensation received by a lessor from lessee for damaged or missing equipment is not considered a ‘‘sale’’ since there is no transfer of property to the lessee. (Section 6006 of the Revenue and Taxation Code.) This is true whether the leased property is purchased tax paid or the lessor is paying tax on rental receipts. 1/18/91.

330.3240 **Delinquent Rental Payment.** When a lessor receives a delinquent rental payment, it will collect tax measured by that rental payment, unless it receives sufficient notification from its lessee that the lessee reported and paid tax on that particular delinquent payment directly to this state. The lessor remains liable

for the payment of the tax in the event that the lessee did not report and pay his tax directly to the state when the rent was due. 8/25/65.

330.3280 **Dismantling Charges.** Separately stated charges for dismantling leased personal property (tents and scaffolding) are excludable from taxable rental receipts if the lessee is free to lease the property without having to hire the lessor to do the dismantling. 12/28/66.

330.3297 **Dues.** A club charges annual dues to members. Membership in the club entitles a member to rent property from the club at a lower rate than would be charged to nonmembers. The primary purpose for belonging to the club is to obtain the reduced rental rate.

The dues are regarded as advance rental payments. If club membership also provides other amenities, the value of the other amenities should be deducted from the dues in arriving at the amount of dues subject to tax. 1/30/73.

330.3300 **Dues and Fees.** Initiation and monthly fees of a ''club'' which only entitle the payors to rent airplanes at a lesser rate per hour than would be charged a ''nonclub member'' are in the nature of advance rental payments and are includable in taxable rental receipts. 7/23/69.

330.3305 **Early Termination by Purchase.** Where a lessee purchases leased equipment before the end of the lease term and before the time for exercising an option to purchase under the terms of the lease contract, the agreement to purchase is a new contract and the measure of tax on the purchase is the entire amount agreed to be paid for the transfer of title, exclusive of any amount for sales tax reimbursement, regardless of the price specified in the option provision of the lease contract. If the lessee gives the lessor a security deposit at the commencement of the lease and the lessee is not in default under the lease at the time of his purchase, the amount of the deposit is also includable in the measure of tax on the purchase if it is not refunded to the lessee. 8/7/78.

330.3310 **Erection (Reassembly).** Charges for erection (reassembly) are for a service connected with a lease (continuing sale) and the application of the tax to such charges turns on when the lease commences and whether the erection is optional or mandatory. If the terms of the lease indicate that the lease does not commence until the reassembly is completed, charges by the lessor are subject to tax. If the lease commences before the reassembly, and the reassembly is optional, charges by the lessor for the erection are nontaxable. 7/16/68; 1/30/87.

330.3320 **Fabrication.** A lessor's charges for fabricating leased exhibits at exposition and fair sites are includable in his taxable rental receipts while his charges for installing such exhibits are not includable therein. 4/16/70.

330.3327 **Field Layout and Sprinkler Pipe Placement.** In connection with the rental of a farm sprinkler system, the lessor performs the service of field layout and attachment of the sprinkler pipe to the real property. Such service constitutes installation labor and is specifically excluded from tax whether performed before or after the lease term begins and without reference to whether the installation is mandatory or optional. 7/22/92.

330.3330 **Franchise Fee.** The initial franchise fee and the additional payment fee for the use of machines which are leased by a corporation to its franchisees are taxable. 12/2/69.

330.3335 **Guaranteed Rentals.** When a leasing contract provides for a guaranteed minimum period and the lessee is obligated to pay the full guaranteed rentals for that period, tax applies to the entire guaranteed rentals although partially collected through court judgment. 4/18/72.

330.3340 **Indemnity Payments—Rentals After Loss of Property.** When a vehicle under lease is completely destroyed in a collision during the term of the lease, sales tax is applicable only to rental receipts up to the date of the accident. All other payments by the lessee due under the lease contract are not

taxable because those payments are indemnity payments for the loss of the vehicle rather than rental or purchase payments. 1/27/70.

330.3350 **Installation Charges.** Installation charges for leased artwork which are included in rentals payable are excluded from the measure of tax pursuant to section 6011(c)(3). However, if the artwork is fabricated in the process of installation, this would be regarded as fabrication labor and not excludable installation labor. 1/12/90.

330.3360 **Insurance Charges.** When the lessee of an automobile is required under the lease contract to obtain automobile insurance for his own benefit and the lessor selling such insurance makes an additional charge, separately stated therefor, the charge for insurance is excludable from the lessor's taxable rental receipts provided the lessee is not required to purchase the insurance from the lessor, but may purchase it from an insurer of his own choice. 7/13/66.

330.3400 **Interest Payments.** Where tangible personal property is actually leased, and not sold on credit, amounts designated by the lessor as interest, which are payable by the lessee in addition to amounts designated as rentals, are includable in the measure of rental payments subject to tax. 3/20/68.

330.3420 **Interest Payments.** Inasmuch as leases are continuing sales under the terms of the new law, the amount designated as interest is not excludable from gross receipts with respect to which the tax applies. 8/5/65.

330.3424 **Late Charges.** A lessee fails to return leased property timely. As a result, an additional payment is required by the lease contract. This payment is considered to be a charge for continued possession of the property and is subject to use tax, regardless of whether the payment is designated as a rental or a penalty. However, if the lease contract meets the statutory requirements for a liquidated damages provision, the amount in excess of the normal rental would be regarded as nontaxable liquidated damages. To qualify as nontaxable liquidated damages, the contract must specify that the payment is for liquidated damages and that both parties have agreed to a specific amount. 8/21/91.

330.3425 **Late Charges.** An additional payment made by a lessee for failing to pay his rental payment timely is not regarded as part of the taxable rental receipts. 5/1/74.

330.3426 **Lease Payments Made Prior to Delivery of Leased Property.** A lessor purchases property as specified by the lessee. The lease payments begin on execution of schedules listing the leased property. The lease provides for ''interim rent'' for the period beginning when the lessor advances funds for the purchase of the property and ending when the schedules are executed.

The ''interim rent'' is subject to tax. It is in the nature of interest and the lease would not be executed if the ''interim rent'' is not included. The ''interim rent'' is regarded as part of the amount which the lessee is required to pay to obtain the use of the property. 9/23/82.

330.3427 **Lease with Option to Purchase.** A rental contract for water ozonation equipment requires an initial payment of $25,000, an additional payment of $20,000 on the tenth day after start up and payments of $2,500 per month for at least four months. If certain savings on electrical costs are realized by the customer, the customer is required to purchase the equipment at the end of the fourth month for $99,635 less credit for the two large payments made at the beginning of the lease term. Otherwise, the purchase is optional.

If the conditions in the contract are not satisfied, the customer is not required to purchase the property. If those conditions are not satisfied, the customer has the option to purchase the property for an option price that is not nominal. The contract is therefore a lease and not a sale at inception. 3/2/93.

330.3428 **Lease of Compact Disks.** A person who obtains compact discs (CDs) and places information on them for purposes of leasing is not leasing them in substantially the same form as acquired (blank CDs).

Therefore, the lease of such CDs is a taxable continuing sale and the lessor must collect use tax from the customer measured by the rental payments and pay it to the state.

In addition, for a fee, some customers may call a 1–900 telephone number to receive information from the lessor's computer system. The information is provided to the customer verbally or electronically by fax.

The access by telephone for voice or fax transmission is not regarded as the sale of tangible personal property and, therefore, this charge is not taxable. 11/21/94.

330.3429 **Loan of Coffee Machines.** A taxpayer is engaged in selling and leasing espresso coffee machines which it purchases in Europe. As a sales incentive, the taxpayer offers machines to customers on a trial basis. During this test period, the taxpayer collects a fee from the potential customer based on the number of cups served. Less than one-half of the fee is for the coffee beans.

The machines which are provided on a trial basis are regarded as being leased. The lease amount is the fee less the charge for the coffee beans. Tax applies to the amount of the lease payments. 1/23/95.

330.3430 **Luxury Tax—Nonqualifying Lease.** Where the lessor leases the vehicle under a nonqualifying lease, the first retail sale is the sale of the vehicle to the lessor and the federal luxury tax is imposed on that sale, not on the lease. A nonqualifying lease is a lease with a term of less than one year, such as a daily or other short term rental. Where the luxury tax is not imposed upon the transaction subject to sales or use tax, the luxury tax cannot be passed through to that subsequent taxable transaction and excluded from the gross receipts of that transaction. Thus, no amount of the rentals on daily or short term rentals is excludable from the measure of tax. 6/22/92.

330.3435 **Luxury Tax—Qualifying Lease.** Revenue and Taxation Code section 6012 excludes taxes imposed by the United States upon or with respect to retail sales. The federal luxury tax is a tax on retail sales which includes leases. When a lessor of a qualifying lease elects to pay the luxury tax up front, he or she is paying a federal excise tax on the lease which is a retail sale. Qualifying lease is a lease with a term of one year or more. Thus, the luxury tax on the lease is a tax imposed by the United States upon or with respect to retail sale, and is excluded from gross receipts. Assuming that the lease is a continuing sale and purchase, the amount excluded is a portion of each rental payment which, if the rental payments are equal, is calculated by dividing the total amount of the luxury tax by the number of rental payments due under the initial term of the lease.

Where the luxury tax is imposed on rental payments, the amount of the luxury tax on each rental payment is excludable from the measure of tax whether the luxury tax is separately stated or included in the rental payments set forth in the lease. Also, if the lessor elects to pay the luxury tax up front and the lessee reimburses the lessor for the tax at the beginning of the lease, the reimbursement is not included in the measure of tax. 6/22/92.

330.3438 **Maintenance Agreement.** A lessor's customers have an option of either leasing business equipment pursuant to a single contract which contains the lease provisions and a maintenance agreement, or leasing business equipment pursuant to two separate contracts, one for the lease and one for the maintenance. Under either scenario, however, the lessor's customers are required, as a condition of leasing the equipment, to purchase some form of maintenance agreement exclusively from the lessor. That is, the lessor will not lease equipment to a customer unless that customer also purchases a maintenance agreement.

Under these facts, the lessor's ''separate'' maintenance agreement is regarded as a mandatory maintenance contract and is, therefore, part of the taxable rental receipts from the lease of its equipment. Therefore, the lessor is required to collect use tax from its customers on this amount and remit it to the Board. The fact the lessor charges its customers a ''one-time'' lump-sum lease payment for its ''separate'' maintenance agreements does not effect the application of the tax. 5/17/96.

330.3440 **Maintenance Charges.** Sales tax is applicable to excess maintenance charges paid by a lessee of computer equipment because the excess maintenance charges, pursuant to the lease agreement, were part of the taxable rental receipts. 6/26/70.

330.3448 **Maintenance Contract.** A lessor leases computer equipment. Excerpts from the agreement for the lease of computer equipment between the lessor and customer (lessee) states that:

(1) Customer shall enter into and maintain in force a standard maintenance agreement (with the manufacturer of the computer) covering at least prime shift maintenance of the machines. Customer will cause the manufacturer to keep the machines in good working order in accordance with the provisions of such maintenance agreement and to make all necessary adjustments and repairs to the machines, and customer shall allow the manufacturer access to the machines for such purposes. The manufacturer is hereby authorized to accept the directions of customers with respect to such maintenance adjustments and repairs.

(2) Charges for the manufacturer's maintenance agreement and all other maintenance and service charges, including installation and dismantling, shall be borne by customer, and customer agrees promptly to reimburse the lessor for any amount thereof paid by the lessor.

In the above lease agreement, the lessor does not designate the lessee as its agent in securing maintenance service and the customer is not reimbursing the lessor for the lessor's cost under the maintenance agreement if payments for the maintenance agreement are made by the lessor. There is no master agreement between the lessor and the maintenance company under which the lessor agreed to require its lessees to secure maintenance contracts with that maintenance company.

Based on the above, the charges for the maintenance service are not included in taxable rental receipts whether or not these charges are paid directly to the maintenance company by the lessor or the customer. The determining factor, based on the above conditions, is that the obligation to secure maintenance service is the obligation of the lessee. 3/12/71.

330.3450 **Maintenance Fees Paid by Lessees to Third Parties.** Maintenance fees paid by a lessee to a third party maintenance contractor are not included in the measure of taxable rental receipts. This is true even though the contract between the lessor and the lessee may specify and require that the lessee contract with a particular named maintenance company (assuming the lessor and the maintenance company are not related corporations). 3/4/83.

330.3453 **Maintenance of Leased Plants.** A lessor leases plants. The lessees are required as a condition of the lease to pay for maintenance of the plants by the lessor. Because the maintenance is mandatory, the entire lease payment, including the maintenance charge, is subject to tax. 2/21/84.

330.3460 **Maintenance Services and Charges for Warranty.** Where equipment is leased under a contract which provides that the lessee must contract with the lessor for parts warranty or maintenance services, the charges for such services are includable in taxable rental receipts. Separately stated charges for optional warranty or maintenance services are excludable from taxable rental receipts. 5/19/67.

330.3465 **Monthly Rental Fees—Video Cassettes.** A machine based video library is implemented at large residential apartment complexes. Residents pay a monthly fee to be a member of the library on a month-to-month basis, without being required to be a member for additional months. For this fee, they receive unlimited borrowing privileges from the library. To prevent hoarding of video cassettes, a penalty fee is imposed on overdue items.

This program is an arrangement to lease video cassettes and is considered a sale and purchase. The membership fees are rentals payable from the lease of the video cassettes and are subject to tax. The only exception would be when a member borrows no cassettes for the month to which the membership fee relates. Penalty fees which are required to be paid relate directly to the lease of video cassettes and are also subject to use tax. 7/9/90.

330.3470 **Operator Services.** When a transaction is a true lease, because the lessor will lease the property with or without an operator, the charges for the optional operator are not part of the rentals payable from the lease, for purposes of the sales and use tax. However, if the optional operator performs fabrication for a consumer, the charge for the operator is taxable as a sale of tangible personal property, unless the operator qualifies as a ''special employee'' of the lessee. 4/8/93.

330.3500 **Option to Purchase.** Charges for property taxes, insurance, repairs and interest paid by the lessee upon exercise of an option to purchase leased equipment are included in the measure of the tax arising out of the sale. 12/15/65.

330.3508 **Optional Items on Lease Contract.** A lessee of a motor vehicle has the option of purchasing an extended service agreement; life and accident and health insurance; vehicle insurance to cover remaining lease liability in the event of theft or destruction of the leased property; and other charges which are not part of the cost of the leased vehicles such as Federal Luxury Tax. The charges for these items are not subject to tax whether paid in total at the start of the lease or paid in installments with the lease payments. If paid in installments, they need not be separately stated on the installment billings. If they are not, they must be separately stated on the lease agreement. 5/16/94.

330.3530 **Property Taxes Where Bank is Lessor.** Where a bank is the lessor of personal property and personal property tax is assessed against the property in the hands of the lessee, the amount of the personal property tax is not includable in taxable rental receipts. 3/5/69.

330.3533 **Property Taxes Where Financial Corporation is Lessor.** Personal property taxes assessed against property leased by financial corporations are the responsibility of the lessees and are not part of the taxable rental receipts of the lessor. Financial corporations, since 1981, are the same as banks. Both banks and financial corporations are exempt from personal property taxes. Therefore, such taxes are the responsibility of the lessee. 1/27/89.

330.3535 **Property Taxes.** Whereas lessee is required by the rental contract to pay for any personal property taxes assessed on the leased property, the amount so paid will be regarded as part of the taxable rental receipts whether the tax is assessed directly against the lessee or the lessor. The foregoing is only applicable when the rental receipts are subject to tax. 2/24/69.

330.3538 **Rentals of Sprinklers, Pipe, Pumps, and Related Accessories.** Taxpayer is a corporation engaged in the business of renting sprinklers, pipe, pumps and related accessories. The taxpayer also charges for installation, removal and delivery of these items. The taxpayer claimed that the installation charges were for field layout and connection and that services occurred after the rental period began. In addition, these services were strictly optional.

The charges for installation are specifically excluded from tax, whether performed before or after the lease term begins and whether the installation is mandatory or optional. (Section 6011 (c)(3).) The charge for the temporary field assembly of the sprinkler components does not constitute a sale of tangible personal property. There is no fabrication of components and the actual labor of assembling the sprinkler components does not constitute a step or process in the production of property.

The charge for delivery are subject to tax where the amounts are not separately stated and the evidence does not show that the delivery was performed after the lease began.

Since the return of the property to the taxpayer is an express condition of the contract, no portion of the charge for removal of the leased property is excludable from the measure of tax. The amount charged for this service is part of the rental receipts subject to tax. 4/26/90.

330.3539 **Repossession Charge.** Repossession charges for costs incurred in repossessing a leased automobile that are separately collected from a lessee are in the nature of damages and are not part of the total consideration paid for use of the property. Tax does not apply to such charges. 3/5/75.

330.3539.100 **Rock Crushing Operations.** A company's receipts were made up of an hourly unit charge for crushing rock and other road-based materials, plus a separately stated move-in and move-out equipment charge. The company believes that its operations actually amounted to a rental of fully operated equipment. The workmen who operate the equipment and who are generally on the payroll of the company consist of:

(1) The Loader. (It is not uncommon for the lessee to provide its own tractor and loader).

(2) Crusher operator. (The master labor agreement requires that an oiler and generator operator be provided with every crusher operator. The company's lessees have, as a matter of convenience and efficiency, uniformly employed all three of these persons as a team.)

(3) The oiler.

(4) The generator operator.

(5) The laborer. (On occasion is provided by the lessee).

It is claimed that the right to control the work of all five persons, while on the job, rests with the lessee who controls when the people start or stop work, the rate of their work, when they take breaks and to what size to reduce the material being crushed. It also is claimed that the lessee has the right to hire and fire employees subject to the company's review and approval. The company believes that the rock-crushing transactions are leases of fully operated tax paid equipment.

The information presented does not indicate that the company's customers had the right to use the property. The equipment was operated by personnel in the general employment of the company and they received their instruction's from a supervisor in its general employment. While it is claimed that the customers had the right to direct the employees when to begin work, when to stop, etc., how much rock to load, it has been judicially determined that such limited authority does not establish an employment relationship. It must also be conceded that the customer did not have the right to select or discharge the workmen. They could only request the company to do so. It is concluded that the activity should be classified as a taxable processing of tangible personal property by the company as an independent contractor. 6/14/74.

330.3555 **Security System.** A taxpayer leases a security system to the owners of an apartment building. The lease provides for a monthly payment of $9.95 which is stated to include finance charges and alarm monitoring services.

The entire charge is subject to tax. Interest charges are excluded from rental receipts only if they are imposed for failure to make timely payments. The alarm monitoring service is not optional or separately stated. Thus, the service is considered related to the sale (lease) of tangible personal property. 2/28/94.

330.3560 **Services and Maintenance Leases.** Where the contract is for the rendition of a service as distinguished from a rental of tangible personal property, the tax would not be applicable to the amounts paid to the person providing the service. This would be true even though in performing the service, use of equipment is involved. If the use of the equipment is entirely under the control of the person furnishing the service, particularly if the furnishing of such service is authorized by appropriate governmental agencies and is subject to their regulations, apparently only a service is being performed. Where, however, the contract specifies that there will be a rental of certain property or where property passes into the possession of the other party to the contract, there is a rental. If it is optional for the customer to purchase the services of a driver or other personnel, a separate charge for such additional services could be excluded from the measure of the tax. If maintenance is a condition of the lease, i.e., it is mandatory that the lessee purchase such maintenance, the entire receipts are taxable. If the maintenance is optional with the lessee, separate charges for such optional maintenance could be excluded from the amount of rental payments subject to tax. 10/5/65.

330.3565 **Services that Are Part of the Lease.** A lessor is in the business of leasing costumes to the motion picture and television industries. Under the terms of the lease, the lessee (producer) must either clean the costumes before returning them or pay the lessor for this service. Other services provided are alterations, dying, and on occasion selection of costumes for the producer when the producer's wardrobe personnel are not available. Charges for these services are separately invoiced to the producer.

With respect to these leases under which these services are performed, the lessee must pay for those services both as a condition of the lease and in order to make use of the costumes. The fact that the producer may avoid the charges by performing these services itself, e.g., selecting the wardrobe, etc., does not mean that these services are not part of the lease when the parties so agree. Thus, the separately stated charges for alterations, selecting, cleaning and dying are subject to tax. 9/23/83.

330.3575 **Termination Fee.** When a lease contract requires the lessee to pay the lessor a ''termination fee'' at the end of the lease term, the ''termination fee'' is usually merely an additional final rental payment. Such a fee is subject to the use tax. Even if the lessee is advised that the fee covers costs associated with processing the lease payoff, this is merely an overhead expense that cannot be deducted from taxable rentals whether separately itemized or not. 6/10/94. (Am. 2008–1).

330.3580 **Trade-In Allowances—Lease Contracts.** Amounts allowed for merchandise traded in on leased merchandise must be included in the measure of tax which must be collected and paid by the lessor under the new law, effective August 1, 1965. 7/26/65.

330.3590 **Transportation Charge.** When the lease receipts paid to a sublessor, by the sublessee, are taxable, the charge to the sublessee to ship the property back to the original lessor is not subject to tax, provided the sublessee has the option to provide his/her own return transportation. However, if the sublessee, as a condition of the sublease, is required to pay the sublessor to ship the property, the charge is taxable. 11/15/89.

330.3600 **Vehicle License Fees.** The license fees included in a monthly lumpsum charge made to lessees by an automobile leasing corporation are not taxable as part of the rental receipts. 8/26/69.

330.3620 **Vehicle Rebates.** Where a leasing company receives rebates from automobile manufacturers because of the company's purchases of vehicles for placement in lease service, and retains the rebates for its own use, with the lessee deriving no benefit, or applies them to a lessee's deposit account, the rebates would not be taxable lease income since they would constitute reductions in the company's cost of acquiring the lease vehicles. 12/20/68.

330.3625 **Video Rentals—Late Fees and Processing Fees.** A video rental store charges members a late fee of $1.50 per day when a video is returned late. If a person wishes to rent videos but is unable or unwilling to present a drivers license and a major credit card, they may still become a member if they pay a one-time non refundable processing fee of $3.00.

Both fees are considered part of gross receipts under section 6012 of the Sales and Use Tax Law. The late fee is in reality a rental fee for the continued use of the video. The processing fee is part of the gross receipts that is received for renting videos. 7/8/93.

330.3628 **Videotape Rental—Rewind Charge.** A rewind fee is considered an optional service and not subject to tax when customers can avoid paying the fee by rewinding the videotape themselves. 3/27/90.

330.3629 **Loan of Equipment for Promotional Purposes.** A computer hardware manufacturer enters into an agreement with a software developer which provides that the manufacturer will loan computer equipment to the developer on a temporary, no-charge basis. The developer uses the computer at trade shows and customer sites for promotional and demonstration purposes. The loan period is for eighteen months during which time the manufacturer carries the computer on its books as inventory and takes no depreciation. The computer is placed in inventory and held for sale when it is returned. In return, the manufacturer receives certain intangible rights from the developer, the developer provides the manufacturer

with advertising space in the developer's magazine, and the manufacturer receives certain royalties. The agreement is regarded as a lease since the manufacturer receives consideration for the granting of possession of the computer to the developer. Tax is due based on the amount of time that the computer is in California and the value of the consideration received. 5/5/94.

330.3630 **Wet Rentals.** The measure of tax with respect to the rental of an automobile leased on a ''wet rental'' basis includes amounts credited to the lessee as reimbursement for gasoline purchases made by the lessee where the lessee has purchased the gasoline as agent for the lessor. The lessor may take a tax-paid purchases resold deduction for tax reimbursement paid by the lessee, on behalf of the lessor, to the service station dealer upon the purchase of the fuel. The sale by the dealer under these circumstances is regarded as a sale to the lessor for resale to the lessee. 9/26/72.

(c) CONTINUING SALE AND PURCHASE

330.3634 **Assignment of Lease.** A lessor timely paid tax or tax reimbursement on the purchase price of the property. The lessor will transfer the lease, including all rights, title, and interest in the equipment, to a newly formed subsidiary which will continue to lease the equipment to the same end user. The property will be transferred to the new subsidiary solely in exchange for first issue stock with no assumption of liabilities or other considerations. Thus, the transfer of the property subject to existing leases to the new subsidiary is not taxable.

The transfer of assets directly to a wholly-owned subsidiary solely in exchange for first issue of stock of the subsidiary is not subject to tax. When property subject to an existing tax-paid lease is transferred, as in this case, the rental payments received during the term of that lease are not subject to tax. However, in the present lease, the new lessor did not pay tax or tax reimbursement on its acquisition of the property and did not receive the tax paid status of the property from its transferor (the transfer was not substantially all the tangible personal property of the original lessor). Thus, a renewal of the existing lease or any new lease would be a continuing sale and purchase, subject to use tax measured by rentals payable. 1/24/97.

330.3635 **Chemical Toilets.** A lease of a chemical toilet is always a taxable continuing sale and purchase, and the lessor may not avoid this by paying tax or tax reimbursement on purchase price. If the lessor does pay tax or tax reimbursement on purchase price and leases the chemical toilets without making any other use of them, the lessor may take a tax-paid resold deduction. 7/19/96.

330.3636 **Computers.** A partnership, formed out of state for the purpose of leasing business computers, leased two computer systems in California.

(1) A computer system previously leased out of state was sold to a funding group, immediately leased back, and then leased by the partnership to a third party in this state. The leaseback to the partnership was a true lease and not a sale at inception because the funding group retained title in the equipment at the end of the lease term. The partnership claimed that it cannot be held liable for any tax on its lease to the third party on the grounds that the funding group and not the partnership was the owner of the equipment.

Under sections 6010.1, the lessor is the seller and is thus responsible for any tax. Nothing in the statute conditions the lessor's responsibility for tax on holding legal title to the leased property. The partnership leased a computer system in this state and was therefore the seller responsible for any applicable tax regardless of whether the partnership was the ''owner'' of the property. The lessor was responsible for payment of tax on its lease receipts.

(2) The partnership purchased a computer system. In order to finance the purchase, it sold the equipment to a funding group and immediately leased it back, and then leased it to a third party in this state. The invoice for the purchaser of the system stated ''plus sales tax.'' The tax was equal to four percent of the purchase price. The partnership claimed that it paid Michigan tax or tax reimbursement and that the lease was not a ''sale'' or ''purchase.''

Although the Michigan tax or tax reimbursement was paid on the acquisition of this system, the tax was paid at the rate of 4% which was less than the applicable California tax. Since the Michigan tax or tax reimbursement was less than the applicable California tax, the partnership had two options when it placed the system into rental service in California, i.e., tax on rental receipts or tax on purchase price with a tax paid credit for Michigan sales tax. Since the partnership failed to file a timely return reporting tax on the purchase price, the partnership no longer had an option. Tax was due on the rental receipts without credit or deduction for the Michigan tax or tax reimbursement. 6/12/89.

330.3638 **Equipment Leasing.** A partnership was established to lease equipment to a corporation of which the partners were also corporate officers. The partnership purchased equipment in Minnesota which was shipped by common carrier to California. The vendor added 6½% sales tax. The partnership believes that since the payment of the tax is equal to the California tax rate, it should be deemed to have made a timely election to pay its use tax based on cost and not be required to report based on rental receipts.

Since the Minnesota statute provides that a sale is exempt if the property is shipped outside of Minnesota, the sale appears to be exempt from Minnesota's tax as a sale in interstate commerce. There is no evidence to show that the vendor remitted the money to the State of California. Since any tax remitted to the State of Minnesota was paid in error and is subject to refund, an offset cannot be allowed. Unless the partnership can show that the tax was due to the State of Minnesota or that the vendor directed the money to the State of California, tax is due measured by the lease receipts. 1/16/91.

330.3640 **Interstate Use by Lessee.** Trailers or containers used in conjunction with flat cars, e.g., piggyback equipment, are not within the category of ''rail freight cars,'' as that term is used in section 6368.5 of the Sales and Use Tax Law. Under the provisions of section 6006.1, the granting of possession of tangible personal property by a lessor to a lessee is not limited to the initial delivery, but is a ''continuing sale in this state'' as respects any period of time the leased property is situated in this state ''irrespective of the time or place of delivery of the property to the lessee.'' Even if the use by the lessee be considered as exempt from use tax because the equipment is placed in interstate use outside this state and continues in such use while the property is in this state, the sales tax applies to the rental receipts. 10/5/65. (See section 6006(g)(4) in effect November 8, 1967.)

330.3650 **Lessor/Lessee Merger.** A lessor merges with a lessee pursuant to a statutory merger. Upon merger, the lease relationship ends. The surviving corporation will now ''use'' the equipment. As such, it will be liable for use tax on the property acquired ex-tax, as measured by its original purchase price, with an offset for the amount of taxes paid on the rental receipts of the property. 12/11/86.

330.3655 **Lease of Property Not Purchased for Use in California.** When a person (lessor) leases property, which was purchased outside California and functionally used for more than ninety days prior to its entry into the state, the lessor is not regarded as having purchased the property for use in California. As such, the lessor owes no use tax on his/her consumption of the property in this State. However, whenever a lessor leases tangible personal property here, which was originally purchased for use elsewhere, the lease is a continuing sale and subject to tax on the lessee's use of property in California, as measured by the rentals payable.

This applies regardless of the fact that the lessor has paid tax to the other state based on the purchase price of the property. The credit provisions of section 6406 do not apply, because the lessor, who paid the tax to the other state, is not the person who owes the California use tax on the rentals payable. This is the liability of the lessee. Although the tax is owed by the lessee, the lessor would be required to collect the tax on the rentals and pay them to the Board. 4/11/91.

330.3657 **Leases of Videos by Libraries.** Corporation A sells videocassettes to Corporation B. Corporation B places an inventory of the videocassettes in libraries under an agreement by which the libraries rent the videocassettes to third parties. The libraries retain 20% of the rental and remit 80% to Corporation B.

Under these circumstances, the sale of the videocassettes by A to B is a sale for resale. The placement of the videocassettes in the libraries is a consignment by Corporation B. The libraries' leases of the videocassettes are subject to tax as continuing sales under section 6006(g)(7). 6/24/88.

330.3660 **Mexico—Aircraft Leased in.** The rental receipts from a leased aircraft, which was purchased ex-tax, will not be subject to the tax when the plane is delivered to the lessee in Mexico for exclusive use there. 6/1/66.

330.3680 **Out-of-State Use of Leased Vehicle.** A resident of New York leased an automobile from a New York automobile dealer. Under New York law, the lessor is required to pay New York sales tax ''up front'' on the full purchase price of the vehicle. Two years after leasing the vehicle, the lessee moved to California and continued to lease the vehicle.

Since the lessor did not purchase the vehicle for use in California (did not enter this state within 90 days), the lessor owes no use tax on its use of the vehicle in California. [See note below.] Therefore, it may not elect to pay tax to California measured by the purchase price and take credit for tax paid to another state as provided by section 6406. Since no California tax has been paid on the purchase price, the lease is a continuing sale and the rental payments are subject to use tax. 12/7/93. (Am. 2006–1; Am. 2008–1).

(Note: For the period October 2, 2004 through June 30, 2007, under certain conditions any vehicle, vessel, or aircraft purchased outside of California and brought into the state within 12 months from the date of its purchase is presumed to be acquired for storage, use, or other consumption in California and subject to use tax.) (Regulation 1620(b)(5).)

330.3700 **Property Located In-State.** Under the change in the Sales and Use Tax Law, operative August 1, 1965, with respect to tangible personal property leases, the lessor is required to collect the use tax only with respect to lease payments received while the property is physically located within the state. If a lessee should purchase the leased property at the termination of the lease, he would be required to pay the use tax on the amount he is required to pay in addition to previous rental payments, provided tax had been paid on such rental payments during the period the property was located in the state. 8/11/65.

330.3725 **Rentals of Classroom Computers.** A corporation has a ''classroom'' at its business site which has nine computer workstations and one server. Companies pay the corporation $100 a day to bring ''students'' to use the computers for instruction on the application of various software. The companies provide their own software and instruction but utilize the corporation's computers. The corporation purchased the computers for resale since they eventually will be sold to customers.

The ''classroom rentals'' are considered rentals or leases of the computers. Since the corporation has paid neither sales tax reimbursement nor use tax on the purchase price of the computer and the one-day charge for use of the computers on the premises or business location of the lessor is more than $20.00, the rentals are continuing sales and purchases. Accordingly, use tax is due measured by the rentals payable. When the corporation later sells the computers, these sales are also subject to tax. 3/8/97.

330.3749 **Single Lease.** A retailer who is a lessor of tangible personal property as to which neither sales tax reimbursement nor use tax has been paid is making a continuing sale of that property and must collect use tax from the lessee, notwithstanding the fact that the lessor may have entered into but one lease contract. 2/9/93.

330.3750 **Single Lease.** A taxpayer originally purchased equipment for use in manufacturing furniture in a foreign country. The equipment was purchased ex-tax. The taxpayer immigrated to California and brought the equipment with him/her. The taxpayer stored the equipment in this state for about a year while he/she looked for an opportunity to open another furniture manufacturing business. The taxpayer decided to minimize his/her income taxes by retaining ownership of the equipment and lease it rather than contributing it to a corporation. There were 22 pieces of equipment subject to the lease, which generated lease receipts of $644,915 over a five-year period.

A lessor exercises the privilege of selling tangible personal property over the period of months or years. A lessor must regularly collect the rent, take steps to maintain and insure the property and account for receipts and expenses. Even a single lease is therefore significant exercise of the selling privilege and justifies the tax. (Regulation 1595(a)(1).) 5/27/93.

330.3770 **Tax Paid to Other States.** Leases of ''passenger vehicles'' as defined in Vehicle Code section 465, on which neither sales nor use tax has been paid, are continuing sales and purchases for any period of time that the leased property is in this state, and use tax must be collected by the lessor from the lessee on the rental payments. If the property is removed from the state, the rentals are no longer taxable. Upon the subsequent return of the property to this state, the rentals again become taxable. If, in the interim period, another state has asserted use tax on the use of the same vehicle within its boundaries, the section 6406 credit for tax paid to another state cannot be allowed. Also, section 6406 requires that the other state's tax be paid prior to the use of the property in this state. 2/17/93.

330.3775 **Termination of a Lease.** A lease ceases upon the earlier of repossession of leased property by the lessor or the time the lessor sells its ownership interest in the property and not by the contract definitions in the lease contract. The reason for this is that the lease for sales and use tax purposes is defined by the sale and use tax law and not by contract definitions. While the direct definition of lease in section 6006.3 simply recites that ''lease'' includes rental, hire, and license (with one specific exclusion), section 6006.1 defines continuing sale to be ''granting of possession of tangible personal property by a lessor to a lessee . . . '' Therefore, the Revenue and Taxation Code focuses intention upon the granting of possession. Accordingly, the lease continues while the lessee retains possession with the acquiescence of the lessor. 12/19/80.

330.3780 **Transfer of Artwork for Reproduction Purposes.** Corporation B purchases original artwork and issues resale certificates to sellers. Under the purchase agreements, B retains all rights and interest in the artwork, including reproduction and licensing rights. B then transfers possession of the artwork to Corporation A which uses the artwork to make reproductions. After Corporation A has finished using the artwork for making the reproductions, it returns the artwork and pays B.

Under this scenario, B is leasing the artwork to A. The lease is a continuing sale and purchase since B issued a resale certificate when it purchased the artwork, and B must collect and pay use tax measured by the amount of consideration it receives from A. This includes all the amounts B receives from A under the transaction, whether it is referred to as royalties or licensing fees, and whether it is paid as a lump sum, periodically or based on the number of reproductions sold.

If Corporation B photographs the original artwork and sells the negative to A, who uses the negative to make reproductions, B has made a taxable use of the artwork and must pay use tax measured by its purchase price. B has also made a sale of the negative to A and must pay sales tax on the sale. The gross receipts subject to tax include all the consideration received from Corporation A, no matter what label is given to such amount (i.e., royalties, licensing fees, etc.). 1/20/93.

330.3786 **Vendor Reporting Tax on Property Leased without Collecting Tax Reimbursement from Lessor.** The lessor is not bound by the unilateral action of the vendor who may report sales tax on the transaction without collecting reimbursement from the lessor. Thus, the lessor is regarded as reselling the property in a taxable lease transaction without regard to whether the vendor may unilaterally have chosen to pay sales tax without collecting sales tax reimbursement from the lessor. The vendor, in this situation, is entitled to a refund of the tax which it paid and the lessor owes tax on rentals. A lease is a taxable continuing sale unless the lessor pays sales tax reimbursement or use tax on purchase price. If the lessor fails to make a timely election to do so, the person selling to the lessor is making a sale for resale and the lessor is making a taxable retail sale. 9/9/85.

(d) ''SUBSTANTIAL CHANGE IN FORM''

330.3900 **General Rule—Substantial Change in Form.** If equipment is not leased in substantially the same form as acquired, a lease of that equipment is a continuing sale and the use tax measured by the

rentals payable must be collected and remitted. It is irrelevant that tax was paid on the purchase price, ‘‘cost,’’ or ‘‘value’’ of the equipment. If tax has been paid on the purchase price of equipment which, prior to any use, is leased in California, but not in substantially the same form as acquired, a tax-paid purchases resold deduction may be taken for those taxes.

In situations where there has been a substantial increase in the value of the leased property, the general rule is that the substantial increase in value alone is enough to show that the property is not leased in the same form as acquired. However, other situations exist where there is a change in form, but little increase in value. In such instances, the fact that there is no substantial increase in value is irrelevant if there is a change in form between what the lessor acquired and what the lessor leased such that the property is not leased in substantially the same form as acquired. 2/17/67; 5/2/94.

330.3920 **Assembly by Lessee with Supervision by Lessor.** Where the lessor acquires all component parts, leases the parts to a lessee who assembles them into the form in which used, the property is leased in substantially the same form even if the lessor provides personnel, free of charge, to offer technical assistance and supervise the assembly and installation. 12/31/68.

330.3940 **Boat and Motor.** When a lessor purchases a boat from one vendor and a motor from another, both with tax-paid on the purchase price, and attaches the boat to the motor and then leases the boat with the motor attached, whether the property leased is in a substantially different form so as to subject the rentals to tax depends upon whether or not a significant amount of fabrication labor is required to attach the motor to the boat. If it is only necessary to bolt or clamp the motor in place this would not result in a substantial change in form. If, however, the boat must undergo significant alterations in order to install the motor, a substantial change in form would result. 8/31/66.

330.3955 **Costume Rentals.** Costumes are constructed entirely by the lessor and then rented. Sales tax reimbursement is paid on materials used to construct the costumes.

The costumes made by the lessor are not leased in substantially the same form as acquired. Therefore, the lease is a continuing sale subject to use tax measured by rentals payable. However, the lessor may take a tax-paid purchase resold deduction for sales tax reimbursement paid on the purchases of materials incorporated into the costumes. 6/10/94.

330.3960 **Credit for Tax Paid on Purchase.** Commencing August 1, 1965, if property leased is not in substantially the same form as acquired, but tax was paid upon the acquisition of the property, and no use is made of the property before leasing it, the lessor must pay tax on his rental receipts, but may take a credit for the amount of the tax paid on the purchase of the materials. 7/26/65.

330.3970 **Fences.** Leased fences are of two types. First, there are wire and post fences in which the taxpayer takes rolls of chainlink fencing and posts to the jobsite, embeds the posts in the ground, and attaches the chainlink fencing to the post. Such fences are considered leased in substantially the same form as purchased.

The second type of fence is a panel fence, in which the taxpayer manufactures fencing panels out of tubing, chainlink fencing, and sometimes barbwire. After manufacturing such panels, taxpayer takes the panels to the jobsite and attaches them to one another without any need to embed in the ground. Such fences are not leased in substantially the same form as purchased. 9/26/86.

330.3974 **Franchised Restaurant Location.** A restaurant chain/franchiser arranges with a landowner to erect a restaurant building on his land, and leases the land and building from the landowner. The franchiser then purchases tax-paid from various vendors everything necessary to equip and furnish the building as a ready to operate restaurant. The location is then operated by the franchiser until a franchisee is found, or the franchiser immediately franchises it. The franchise agreement includes a sublease of the land and building and a lease of the equipment and furnishings. This activity does not result in a substantial change in form of the property leased and the lease is not subject to tax. 9/12/68.

330.3980 **Irrigation Pipes.**

(1) Irrigation pipe and fittings were purchased tax-paid. A coupler was welded on one end of the pipe and a latch on the other end. A sprinkler was also attached. Under these circumstances, the property was not substantially changed in form and the rental receipts were not taxable.

(2) Irrigation pipe and fittings were purchased tax-paid. One end of the pipe was expanded, a couple was welded on it, nine holes were cut in the pipe, and a gate valve was screwed into each hole. Under these circumstances, the property was substantially changed in form and the rental receipts were taxable. 11/1/67; 8/21/90.

330.3990 **Leases of Scaffolding.** Scaffolding purchased unassembled and assembled prior to being leased is considered to be leased in the same form as acquired. If it was acquired ex-tax lessor may timely elect to report tax on the purchase price or on the rental receipts. When tax is being reported on rental receipts, the taxability of delivery charges is determined by Regulation 1628. Basically, tax does not apply to separately stated charges for delivery made after the lease commences, and tax does apply if the charges are not separately stated or are for delivery made before the lease commences. 3/12/71.

330.3996 **Manufactured Replacement Parts—Sales Tax Paid Equipment.** A lessor leased equipment to a California customer on which it had paid the vendor sales tax reimbursement. The lessor also provides replacement parts for the leased equipment, which it manufactures itself. The rental charges on the machinery are based on machine production. There is no additional charge for the replacement parts.

Under these circumstances, the rental charges remain nontaxable. The lessor should pay tax based upon the cost of the materials incorporated into the replacement parts. The machinery is regarded as having been leased in substantially the same form as it was acquired, notwithstanding the fact that the lessor may furnish replacement parts. Only if the machine were refurbished in its entirety, such that the change in the equipment was so substantial that it was effectively a different machine, would the rental charge become taxable. That is, if after a total refurbishment, the machine was in substance a different machine, it would be concluded that the property was not leased by the lessor in the same form in which it was acquired. 12/18/95.

330.4000 **Minor Repairs.** Minor repairs and adjustments to recently purchased equipment which do not change its functional abilities or significantly increase its value do not constitute substantial changes in form. 8/19/65.

330.4020 **Parking Lot Equipment.** Automatic entry and exit equipment used in parking lots is not leased in substantially the same form as acquired when the lessor engineers and designs the equipment, purchases the numerous component parts from various suppliers, and assembles the parts into the finished equipment. 9/23/68.

330.4030 **Photographers—Rental of Transparencies.** The rental of photographic transparencies that have been developed from exposed raw film is taxable as a sale. The rental is taxable because the property is not rented in the same form as acquired by the lessor who purchased and exposed the raw film. The item being leased is the raw film which was exposed by the photographer and, accordingly, changed substantially in form. This application of tax is correct even though the lessor may have paid sales tax reimbursement to the lab that developed the slide.

On the other hand, if the item leased is a print of the exposed film which was purchased tax paid from the processing laboratory, the print would be leased in substantially the same form as acquired. 1/10/91.

330.4060 **Plants and Trees.** From the standpoint of growth alone, a plant or tree should be regarded as remaining in substantially the same form for purposes of section 6006(g)(5) unless by reason of its growth its value has increased by more than 20 percent.

A tree should be regarded as remaining in substantially the same form after a relatively simple base has been attached to it without extensive fabrication labor. An appropriate test is whether the value of the tree with the base exceeds by more than 20 percent the value of the tree without the base.

Plants or trees should be regarded as remaining in substantially the same form even after they are arranged into a particular pattern where the arrangement is made under the direction and control of the lessee, on his premises, after the lease is entered into, and if the arrangement does not last beyond the term of the lease. The fact that a person who is normally employed by the lessor assists in making the arrangement under the direction of the lessee does not change this result if his assistance is optional with the lessee and if the arrangement does not result in an increase in the rental rate over the usual rate for the plants and trees as separate items. 12/6/67.

330.4070 **Rentals Made by a Separate Division or by a Subsidiary.** A corporation manufactures company uniforms that it wishes to lease in California. If it does so through a separate division, rental receipts will be taxable because the uniforms will not be leased in the form in which they were acquired. The separate division is considered the same person as the manufacturing division. If the corporation sells the uniforms to a subsidiary corporation in an arms length transaction, the subsidiary, being a separate person, will have the option of paying tax on cost or on rental receipts. 2/15/95.

330.4075 **Real Estate Signs.** A franchiser's primary business is manufacturing complete real estate signs including frames, signs and stakes. The completed sign packages are sold to franchisees who in turn rent them to local real estate offices. The franchisees' services include the placement and removal of the signs. Although the completed signs cannot be modified, some models carry riders for attaching additional signs which can be changed depending on the lessee's needs.

Since the completed sign packages cannot be modified, except those models with riders that may be changed with very little effort, the franchisees are considered to be leasing the sign packages in the same form as acquired. The franchisees may, therefore, elect to pay the franchiser sales tax reimbursement or timely pay use tax as measured by the purchase price of the sign packages. Thereafter, they could lease the signs with no further sales or use tax being due on the subsequent rental receipts. Alternatively, provided the franchisee has a seller's permit, they may issue the franchiser a resale certificate and collect use tax from their lessees as measured by the rentals payable. 5/20/88.

330.4080 **Replacement of Truck Chassis.** An individual buys trucks tax-paid and rents the trucks to a corporation, and when the truck chassis wears out, rents another chassis to the corporation, which attaches the body of the old truck to the new chassis. In the above situation, the individual is leasing property in substantially the same form as acquired and is not liable for additional tax. The attachment of the body to the new chassis, being a relatively simple operation, does not require any significant fabrication labor on the part of the corporation. 8/8/66.

330.4090 **Restaurant Equipment.** Management of a restaurant chain (franchiser) purchases individual items of restaurant equipment such as dishes, utensils, pots, pans, etc., on a tax-paid basis, assembles them into a working unit, namely an operating restaurant, and leases the unit as a whole to a franchise operator on a percentage lease. The question posed is that the rental receipts may be taxable on the grounds that the process of assembling the equipment into a ''unit'' results in such a substantial change in the form of the individual items of equipment that the equipment cannot retain its tax-paid status.

In this situation, the physical parts of the unit remain separate and distinct while retaining their original form. There is no physical addition or increase in value of each item. In fact, they could be extracted and leased separately for as much or more than their proportionate share of the total lease.

Accordingly, the equipment is being leased in substantially the same form as acquired and the lessor can retain the tax paid status. 9/5/68.

330.4110 **Scaffolding.** Rental receipts from leases of scaffolding by manufacturers or fabricators are generally taxable since the scaffolding is not leased in substantially the same form as acquired.

On the other hand, when the lessor makes no changes to the component parts (e.g., welding, cutting, etc.,) the components will be considered leased in the same form as acquired, even though the components may be assembled in different configurations for different customers. 6/11/90; 7/10/96.

330.4120 **''Side Shifter'' Added to Fork Lift Truck.** The addition of a ''side shifter'' to a leased fork lift truck, which significantly increased the truck's capabilities, constituted a substantial change in the form of the property being leased. 9/22/66.

330.4140 **Ski Bindings.** The installation of bindings on snow skis does not constitute a substantial change in form. Accordingly, if bindings and skis are purchased tax-paid, no further tax is due when they are rented as a single unit. If the skis are purchased tax-paid and the bindings purchased ex-tax, receipts from the rentals are taxable, and the lessor may deduct the tax-paid cost of the skis. 1/12/68.

330.4160 **Storage Tanks Fabricated by Lessor.** A lessor fabricates storage tanks from steel that it purchases tax-paid. Since the fabricated tanks are not leased in substantially the same form as acquired, the rentals payable from the lessees are subject to use tax. 10/21/65. (Am. 2001–3).

330.4165 **Substantial Change in Form.** Taxpayer purchases ex-tax large spools of insulated copper cable, cuts it into various standard lengths and adds certain adapters and connectors so that the cable can be attached to power distribution boxes, electrical equipment, etc. The cables are then leased to others with tax being paid on the cost of the materials.

The cables are not leased in the same form as acquired and tax is due on the rental receipts, with a deduction allowed for the tax paid on the cost. 12/8/80.

330.4169 **Table Skirts and Drapes.** A retailer rents tables and skirts or drapes for the tables at conventions. These skirts or drapes are rented separately and priced separately from the tables. Table drapes are cut to length from a bolt of material, banded and pleated at the retailer's shop, and attached to the table at the convention site. Labor cost for fabrication of the drapes average 34% of the material cost. Occasionally, customers who have not ordered table drapes will decide at the exhibition site that they want table drapes. The drapes are fabricated at the exhibition site. The rental charge of the drapes is the same regardless of whether the drapes are fabricated at the retailer's shop or at the exhibition site. The criteria used in determining whether property is leased in substantially the same form as acquired is the cost factor rather than to base value on rental price. The argument that, since the rental value of drapes fabricated at the retailer's shop and the drapes fabricated at the exhibition site is the same, the fair market value is the same and there has been no substantial change in form due to the fabrication, is not valid. Here, there has been a substantial change in form. 11/7/86.

330.4173 **Tax—Paid Acquisition by Subsequently Dissolved Corporation.** An individual purchased the common stock of a corporation. The corporation owned real property and tax-paid personal property. The new owner dissolved the corporation and subsequently leased the real and personal property to another person.

The transfer of tangible personal property from the corporation to the new owner was an exempt occasional sale because substantially all of the assets were transferred and the ownership was substantially similar after the transfer. Since the tangible personal property which the new owner leased was leased in substantially the same form as acquired and was tax-paid in the hands of the transferor (the corporation), tax is not due on rental receipts. 7/24/81.

330.4180 **Tuxedo Alterations.** Minor temporary adjustments to rented tuxedos do not substantially change the form of the garments. Thus, since the lessor paid sales tax measured by the purchase price, the subsequent rental of the tuxedos is not subject to tax under Regulation 1660. 8/25/66.

330.4185 **Use of Master Printing Plates—Training Schools.** A taxpayer provides seminar services and training to companies in the area of sales and services. In some instances, the taxpayer also provides the

client with training program material and/or master plates from which the client can print the material themselves. There is a fee for the use of master plates and a license for the right to use these plates which must be returned by the date specified in the contract.

If the taxpayer does not make a separate charge for the training materials which it furnishes to participants when providing significant education services including classroom instructions, then the taxpayer is regarded as the consumer of such materials and tax applies to the cost of such materials to the taxpayer. If, however, the taxpayer makes a separate charge for such materials, the taxpayer is a retailer of such property and tax applies to such charges.

However, when the master plates are furnished, the taxpayer is leasing the master plates to its customers since there is a transfer of possession of the plates to the customer. Thus, the rental receipts from such leases are subject to use tax since plates are not in substantially the same form as acquired by the taxpayers. Such taxable amounts include the fee for the use of the plates and the license fee for the right to use the plates. Taxpayer's charges for the plates (rental receipts) are taxable whether separately stated or not. 1/27/94.

330.4187 **Venture Lease.** A start-up corporation (lessee) will lease equipment in exchange for the granting of a warrant (grants the right to purchase stock in lessee's corporation at a strike price). Lease payments are based on the fair rental value of the equipment. The lessor did not elect to pay California sales tax reimbursement or use tax measured by the purchase price of the equipment. Therefore, the use tax is due on the rentals payable for the leased equipment. The use tax due in this situation is measured by the value of the warrant (at the commencement of the lease agreement) plus the periodic lease payments for the remainder of the lease period.

When a dollar value is determinable for the warrant at the commencement of the lease, such value must be included in the measure of tax for the lease of the equipment. However, if the value of the warrant at the time the lease commences is sufficiently speculative, the warrant is not included as part of the lessee's rentals payable for the lease of the equipment. 4/17/95.

330.4188 **Water Purification Systems.** The taxpayer leases fiberglass tanks which are filled with chemically charged resin for use as water purification systems. These tanks are attached to the customer's water supply pipelines. The ''leased'' tank package is comprised of a shell, a boot, connectors, a head, a cap, a collector, and resin. The shell and boot are purchased pre-assembled and the remaining components, except the resin, are purchased pre-threaded. The unit is substantially completed prior to any preparation by the taxpayer. It takes approximately 10–12 minutes for a technician to install the components and fill the tank with resin.

Under these facts, the components are leased in substantially the same form as acquired. (See Annotation 330.3980 (11/1/67; 8/21/90).) Accordingly, the taxpayer may elect to pay sales tax reimbursement or use tax to its vendor when purchasing the components (except for the resin) that comprise the water purification systems. The taxpayer may also pay use tax, measured by the purchase price, directly to the Board with its timely return for the reporting period in which the property is first placed into rental service. If the taxpayer does not make this election, use tax, measured by the rentals payable, must be collected by the taxpayer from the lessee at the time the rentals are paid.

The resin, which is periodically replaced with new resin to filter out the impurities of the water, is not considered to be leased, but rather is consumed in the process of purifying the water for the taxpayer's customer. Thus, the taxpayer's purchase of the resin is for purposes of reselling this product to its customer. Accordingly, the transfers of resin by the taxpayer to its customers are not leases but sales which are subject to sales tax. 2/8/96.

330.4190 **Water Softener Tanks.** The attachment by a water softener dealer of a water softener tank to plumbing installed by the dealer at the home of his customer does not require a conclusion that the tank and plumbing are a unit leased in a substantially different form than the components, where the tank is temporarily attached to the plumbing by slip connections and is intended to be removed and replaced

approximately every month. The tank itself performs the water softening function and if the form of the tank alone is not changed after the dealer acquires it tax-paid, the charges to the customer are not taxable. 7/7/70.

(e) SALES AND LEASEBACK TRANSACTIONS

330.5019 **Certificate Has No Value.** Section 6010.65 does not provide that an exemption certificate obtained from a seller/lessee attesting that the conditions are met will relieve a purchaser/lessor from possible liabilities if it is found that the conditions were not met. In the event that the conditions of section 6010.65 are not met, no exemption exists and the application of tax is governed by Regulation 1660. A sale/leaseback transaction which does not meet the conditions specified in the statute is not exempt from tax. The lessor, in such a transaction, is liable for any taxes due measured by rental receipts unless he purchased the property tax paid or reported tax timely measured by the purchase price. It is immaterial whether he holds an exemption certificate issued by the seller/lessee.

The adoption of a sale and leaseback certificate is not appropriate since it would have no real value. It would not provide proof that the conditions of section 6010.65 of the Revenue and Taxation Code have been met. Further, it would not relieve the holder of the certificate of possible liabilities if the certificate is not factual and could conceivably mislead a lessor into not collecting tax on a taxable lease. 10/29/90; 5/20/96.

330.5023 **Closely Held Corporations.** The stock of a winery is owned 99 percent by the father and 1 percent by his two daughters. In order to obtain financing to purchase a vineyard and increase the debt/equity ratio of the winery, the father formed another subchapter S corporation (which was 100 percent owned by the father) to purchase used wine barrels from the winery and lease them back to the winery.

The new corporation subsequently purchased additional barrels, and leased them back to the winery. The lease rate was high enough to allow the new leasing corporation to make the loan payments on the money borrowed to purchase the barrels and to make a slight profit. The leasing corporation's only activity consisted of buying these barrels from the winery and leasing them to the related entities. The leasing corporation had neither employees nor payroll. Its operations were run entirely by the winery employees. All books and records were also kept by winery employees. The only indicia of the leasing corporation's existence were (1) a bank account, (2) the books maintained by the winery, and (3) financial statements and other records required by the lender. Three years later when the winery's debt/equity ratio improved to a point that the leasing corporation was no longer needed, the corporation was dissolved through a merger into the winery.

Since both the winery and the leasing corporation were wholly owned S corporations, all of their taxable income was passed through each year to the father. The sale/leaseback arrangement forced the leasing corporation to report the full amount of lease proceeds received each year as income.

In this case, the leasing company (1) owned property and depreciated it, (2) had its own bank account, (3) assumed debts, (4) purchased property on its own, (5) bore the liability to the lender for the purchase price of the barrels, (6) received profits, (7) filed income tax returns, and (8) kept separate books. Therefore, the *Mapo, Inc.* v. *State Board of Equalization* court case is not controlling. In addition, the transaction was structured as if at arms length, i.e., the sales price to the lessor and the rentals payable were commercially reasonable as if between unrelated parties.

Accordingly, the transaction transferring the used barrels from the winery to the leasing corporation was a sale within the meaning of section 6006. Therefore, the transaction was subject to sales tax. However, since the property was immediately leased after purchase and the lessor did not pay tax on the purchase price, the applicable measure of tax is use tax measured by the rentals payable by the winery to the leasing corporation. 4/21/95.

330.5030 **Cross-Border Lease.** An investment company (company A) desires to borrow money by means of a German cross-border lease. To facilitate this transaction, a wholly owned subsidiary of Company A, a

paper manufacturing company (Company B), will sell certain of its paper-making machinery to Company A for an amount equal to the fair market value of the equipment. The sale of the equipment will be followed by a lease back to Company B for $1 per year and provide for an option for B to purchase the equipment for $1 at the end of the lease.

After completion of the leaseback, Company A will enter into the German cross-border lease transaction in which it will sell the equipment to a German leasing company and lease it back for a period of nine years. At the end of lease, Company A will have an option to acquire the equipment for payment of the lesser of 10% of the original purchase price or the fair market value of the equipment at that time. The economic effect of the German cross-border lease is borrowing by Company A, secured by the equipment, at an interest rate approximately 100 basis points below Company A's normal borrowing rate.

Based solely on these facts, the sale and leaseback by Companies A and B will be regarded as a financing transaction which is not subject to tax. (Regulation 1660(a)(3)(A)(1).) Because the sale and leaseback between Companies B and A is regarded as a financing transaction, Company A's interest in the equipment is that of a secured lender. Thus, the German cross-border transaction is regarded as merely a sale and leaseback of the lender's (A) interest in the transaction, and is also not subject to tax. The transaction does not involve a sale or a lease of tangible personal property under the California Sales and Use Tax law. 11/6/90.

330.5046 **90-Day Limitation.** A sale and leaseback agreement was signed by both parties within 90 days of the first functional ''use of the equipment'' by the lessee. However, the funding and drafting of the final document occurred after the 90-day period. Under the above conditions, section 6010.65(a)(2) is satisfied. The transaction would have been consummated on a timely basis, notwithstanding the fact that the sale and leaseback transaction may have remained executory, in part, for a period beyond the 90 day limitation date. Both the sale and the leaseback transaction would be excluded from the definition of ''sale and purchase'' (and thus tax free), since the lessee paid tax at the time of the original acquisition. 3/11/93.

330.5050 **90-Day Rule.** A taxpayer purchased fixed assets without payment of tax or tax reimbursement. The assets were placed in the taxpayer's stores and were functionally used. More than 90 days later the property was sold to a leasing company and leased back. Tax was paid on the lease payments.

Tax is also due on the acquisition cost of the equipment. In order to avoid tax on both acquisition cost and lease payments, tax must be paid on the cost and the sale/leaseback transaction must be completed within 90 days. 1/5/95.

330.5055 **Ninety Days of First Functional Use.** When a person acquires tangible personal property tax paid and enters into a sale and leaseback arrangement within 90 days of the person's first functional use of the property, the sale/leaseback comes within the provision of section 6010.65.

In addition, if the lessor thereafter sells its interest in the property (including an assignment of the lease contract, together with transfer of title to the property) to a third party investor within the same 90-day window period (i.e., within 90 days of the original purchaser's first functional use of the property), this transfer also would fall within the provisions of section 6010.65 and would be classified as neither a sale nor a purchase. 1/12/94.

330.5110 **Sale and Leaseback.** A sale and leaseback agreement will not be treated as a ''nonsale'' financing transaction where the lease contains a provision that entitles the purchaser/lessor, as owner of the property, to claim depreciation benefits for income tax purposes; a provision allowing the lessee to extend the lease period; and a provision that allows the lessee to purchase the equipment at the end of the lease for the greater of fair market value at the end of the lease or ten-percent of the lessor/purchaser's cost. Either the provision allowing the lessor to claim depreciation or the failure to provide an option to purchase at fair market value or less would preclude the application of Regulation 1660(a)(3)(B). 4/12/90.

330.5111 **Sale and Leaseback.** Company A purchased furniture and equipment on a tax-paid basis and then stored the property. Prior to making any functional use, A entered into a sale/leaseback transaction

with a leasing company B. Tax was not paid on the sale to B or the lease back to A. If the sale/leaseback transaction qualified as a financing transaction, the tax would have been properly paid when A purchased the property, and no further tax would be due. However, the sale/leaseback did not qualify as a financing transaction under either the general or specific rule of Regulation 1660. Thus, either the sale to B or the lease to A is subject to tax. Since B did not make a timely election to pay tax on the purchase price, the lease to A was a taxable continuing sale. If A did not depreciate the property for income tax purposes, take investment tax credit, or make any other use of the property except to hold it for resale in the sale/leaseback transaction, it is entitled to a tax-paid purchases resold deduction for the tax or tax reimbursement it paid when it purchased the property. 8/28/90.

330.5120 **Sale and Leaseback.** A purchaser acquired equipment in May and June, 1992, and paid the full price of the equipment, including sales tax reimbursement, at that time. The equipment was installed by purchaser in September, 1992, and its first functional use occurred at the end of September, 1992. By letter dated December 16, 1992, the purchaser and Company X agreed to enter into an equipment lease financing. In January, 1993, the lessor and lessee attempted to finalize the transaction.

In order to qualify for the exclusion from ''sale'' and ''purchase'' one requirement is that an acquisition sale and leaseback be consummated within 90 days of the purchaser's first functional use of the property. The first functional use of the property was in September, 1992, and the sale and leaseback was not consummated until January, 1993, more than 90 days later. The December 16, 1992 letter is not considered to be ''consummation of the lease.'' This transaction does not qualify for the exclusion from ''sale'' and ''purchase.'' (Section 6010.5.) 6/11/93.

330.5140 **Sale and Leaseback.** Company A purchased a computer from Company B on April 30, 1991. It also executed a Licensed End User Agreement for a software program to be used with the computer. On May 29, 1991, Company A purchased an additional piece of hardware from Company B.

Company A had intended to finance the full amount of the purchases, but was unable to do so at the time. It paid Company B approximately $47,000 of the almost $75,000 purchase price. On September 20, 1991 Company A entered into a contract with Company C designated ''Term Lease Master Agreement.'' Company C remitted to Company B $70,000. In turn, Company B refunded the original purchase price to Company A less the amount of sales tax reimbursement.

Company B's sale to Company A is a retail sale notwithstanding the subsequent transaction with Company C. Also, the contract between Company A and Company C did not qualify for the exclusion under section 6010.65.

The transaction took place more than ninety days after the original purchase. An attempt to have an effective date of the lease with Company C of May 15, 1991 is not possible. The property was functionally used by Company A during the period and the ''Term Lease Master Agreement'' contract was not entered into until September 20, 1991 well over 90 days after the first functional use.

Also, the ''Term Lease Master Agreement'' does not qualify as a financing transaction pursuant to Regulation 1660 (a) (3). Under terms of the contract, Company C is entitled to take the maximum Accumulated Cost Recovery System deduction for income tax purposes. Thus, the ''Term Lease Master Agreement'' is a sale by Company A to Company C. 5/12/92.

330.5160 **Sale and Leaseback.** Vendor sold equipment to consumer in October. Sales tax was paid on the transaction. In December, after having made functional use of the property, consumer contracted to sell the equipment to lessor and lease it back. At that time, consumer gave vendor a resale certificate, and vendor credited consumer for the amount of ''sales tax'' included in the original purchase price. Lessor then paid the balance of the invoice to vendor, without payment of any tax or tax reimbursement, and then made a timely election to report tax on rentals payable. The vendor thereafter filed a claim for refund for the sales tax it had paid the Board on its sale to consumer.

Even if there were a valid issue as to whether consumer's sale to lessor qualified under section 6010.65 or Regulation 1660(a)(3), this issue is irrelevant in determining whether the original sale is subject to tax. Vendor did not take a timely resale certificate. Since consumer functionally used the property prior to selling the property to lessor, vendor's sale to consumer cannot be regarded as a sale for resale. The vendor cannot claim a returned merchandise deduction under these facts. There must be an unconditional return of the property to the vendor and a full refund of the purchase price. Here, the vendor simply accommodated the consumer, acting as a conduit, by billing the amount remaining due to lessor. Regardless of the documentation the parties might create in order to make the transaction appear to be a return of property followed by a sale to someone else, in fact, there has been no return at all. Even if this type of transaction could be viewed as a return, the vendor accepted that ''return'' only on the condition that the purchaser furnish a replacement buyer at an equal or greater price than the original purchase price. This cannot qualify for the returned merchandise deduction, and the claim for refund must be denied. 9/28/93. (Am. M99–1).

330.5200 **Sale and Leaseback—Arms Length Transactions.** Tax evasion occurs when taxpayer, a corporation and the manufacturer of mechanical equipment, sells the equipment at cost to the sole owner of the corporation who pays sales tax on the equipment and leases it back to the corporation ex-tax. The corporation then rents the equipment without collecting a use tax. Although such a transaction might be proper if there was true separation of the identities of the parties, the sale and leaseback transaction is not at arms length and the sale at cost, rather than at fair market value, indicates an attempt to evade the use tax the manufacturer would be required to collect if he rented the equipment himself. 8/14/69.

330.5250 **Sale and Leaseback—Financing Transaction.** One of the requirements for sale and leaseback contract to be considered a financing transaction is that the ''lease'' transaction would be regarded as a sale at inception. This requirement is met where the seller/lessee is required to either purchase the property or to sell it to a third party at the end of the lease term.

The sale at inception requirement is also met if (1) A sells the property to B, (2) B is required to lease the property to C, (3) C is required to sublease the property to A, and (4) at the end of the lease term, A is certain to retain ownership of the property. This requirement is not met, however, if C, not A, is required to purchase the property at the end of the lease term. This requirement is also not met if the agreement between the parties provides that C has the option to elect early termination of the lease, (in which case A must purchase the property) but if C does not elect to terminate early, then C must purchase the property. 2/23/90.

330.5251 **Sale and Leaseback—Financing Transaction.** A company purchased a piece of equipment five years ago and paid sales tax reimbursement. Now it wishes to refinance the equipment. The company will sell the equipment for the appraised value. Title will transfer to a buyer/lessor who will lease the equipment back to the company. The lease would have an estimated imputed interest rate of 8.8% compounded annually. At the end of the eleven year term of the lease, the equipment can be purchased for an option price of one dollar.

The company will report the proposed transaction as a loan for income tax purposes, deducting the interest expense portion of the payments. Despite the transfer of title for security purposes, the benefits and burden of ownership will be retained by the company. The company will continue to depreciate the equipment as it has done in the past. The buyer/lessor will treat the transaction consistent with that of the seller/lessee.

Under Regulation 1660(a)(3), a transaction structured as a sale and leaseback will qualify as a financing transaction if three conditions are met: (1) if the lease transaction would be regarded as a sale at inception, (2) if the purchaser-lessor does not claim any deduction, credit or exemption with respect to the property for state or federal income tax purposes, and (3) if the amount which would be attributable to interest, had the transaction originally been constructed as a financing agreement, is not usurious under California law. (Regulation 1660(a)(3)(A).)

Based on the information submitted, it appears that the proposed transaction satisfies each of these three requirements and would qualify as a financing transaction for sales and use tax purposes. Thus, it would not be subject to the tax. 8/12/94.

330.5253 **Sale and Leaseback—Out-of-State Purchase.** Corporation A, located in Texas, purchases equipment from a Texas vendor and pays the vendor Texas sales tax. Corporation A then sells the equipment to a leasing agent and leases it back. Some of the equipment is shipped to and used in California.

The sale and leaseback transaction does not qualify as a financing transaction under Regulation 1660(a)(3)(A) or under (a)(3)(B). Also, the sale and leaseback transaction does not come within the provisions of section 6010.65 under Regulation 1660(a)(3)(D), Acquisition Sale and Leaseback Transactions, since Corporation A paid Texas tax reimbursement rather than California sales tax reimbursement on the purchase of the equipment.

Since the sale and leaseback does not qualify as a financing transaction under Regulation 1660, the lease is a taxable continuing sale unless the lessor timely paid California use tax measured by the purchase price of the property. Thus, if the lessor has paid no California tax or tax reimbursement with respect to its purchase of the equipment, the lease of the property to Corporation A is a taxable continuing sale and tax is due on the rentals payable at the rate in effect at the location where the property is physically located. As a retailer deriving rentals from a lease of property located in this state, the lessor will be required to collect use tax from Corporation A and to pay that use tax to this state. 12/7/95.

330.5255 **Nuclear Fuel.** A utility company purchases uranium ore from independent mining companies and acquires title to the ore. The utility company then contracts with various other companies to have the ore processed into nuclear fuel. The utility company retains title to the ore throughout the various processing stages, until such time as the ore becomes ‘‘nuclear fuel.’’ After various processing stages were completed and the ore became ‘‘nuclear fuel,’’ the ‘‘nuclear fuel’’ was sold to the processing company and leased back. Under the terms of the lease, the utility company will reacquire title to the fuel at the end of the lease term, to the extent such property remains in existence, without paying any consideration other than that already due under the lease.

The fact that the property leased is consumed during the term of the lease does not preclude a sale and leaseback transaction from qualifying as a nontaxable financing transaction under Regulation 1660(a)(3) provided that all the other requirements are satisfied. 12/23/85.

330.5260 **Sale and Leaseback Prior to Functional Use.** Company A, engaged in financing activities, entered into a master lease agreement with company B, which contemplated execution of subsequent separate lease schedules for leases to B. For the first two lease schedules, A purchased the equipment directly from vendors and then leased it to B. However, when B desired to obtain certain equipment sold by a specific manufacturer, B purchased the equipment and paid sales tax reimbursement to the manufacturer. Prior to any functional use, B sold the equipment to A and leased it back under a third lease schedule.

Because of the way the transaction was structured, the third lease schedule, which included terms of the master lease, was a separate contractual agreement from the first two lease schedules. Regardless of the terms of the lease, the transaction between B and the manufacturer was clearly a sale from the manufacturer to B without regard to the manner in which A and B had originally contemplated that the equipment would be acquired. Since B made no functional use of the equipment before selling it to A, the purchase by B will be regarded as a purchase for resale to A. B may take a tax-paid purchase resold deduction with respect to the sales tax paid to the manufacturer. 11/27/89.

330.5265 **Sale and Leaseback Transaction.** A manufacturer proposes to enter into a transaction with a United Kingdom company whereby it will transfer legal title to certain equipment and continue to have all the incidents of ownership pursuant to a contract which is cast in the form of a lease.

The manufacturer’s sole purpose in entering into the proposed transaction is to receive and retain $4.5 million by enabling the U. K. company to retain certain statutory tax benefits available in the United

Kingdom when certain conditions are met. No U. S. benefits are available to the manufacturer or the U. K. company by reason of the proposed transaction.

Assets in the amount of $50 million that will be the subject of this transaction have been acquired sales or use tax paid. At the closing of the title transfer to U. K. company and as an integral part of that transaction, approximately $45.5 million of the total consideration of the $50 million paid to the manufacturer will be deposited by the manufacturer with a United Kingdom bank, an affiliate of the U. K. company that is acquiring legal title to the assets. As a result, manufacturer will receive net proceeds of $45 million. Interest and principal from the $45 million deposit will be precisely equal to, and will be used to pay, all rental due under the lease during the 15 year lease term, so that at the end of that term the deposit will be exhausted and manufacturer's rental obligations during the term will have been satisfied. The remaining $4.5 million will be retained by manufacturer. At the end of the 15 year lease term, manufacturer will have the right to: (1) continue to add the assets ad infinitum upon payment of a nominal annual rental for 5 years and a lump-sum payment of about $400,000, (2) sublease or assign its right to use the assets in perpetuity to whomever it chooses, or (3) if it has no other use for the assets, to sell them to a third party and retain all but 2½ percent of the proceeds.

Since the bank retains title to the property at the end of the lease term and does not relinquish title until such time as the property is disposed of by sale, the transaction is not merely a financing transaction but a sale of the property to the lessor. Accordingly, the transaction is subject to the sales tax. 11/5/81.

330.5268 **Tax Benefit Transaction.** A taxpayer claims that a client-investor contract qualifies as a ''tax benefit transaction'' under Regulation 1660(a)(3)(c). However, subdivision (a)(3)(c) of the regulation applies to sale and leaseback transactions entered into when former IRS section 168(f)(8), as enacted by the Economic Recovery Tax Act of 1981, was in effect. That section has been repealed and, therefore, cannot be applied to a client-investor contract, which was not in existence during the lifetime of former section 168(f)(8). Therefore, the contract cannot qualify as a tax benefit transaction as defined by Regulation 1660(a)(3)(c). 4/30/98. (M99–1).

330.5270 **Title to Property vs. Security for Loan.** A taxpayer enters into transactions in which an owner of real property purports to sell both real property and personal property contained therein to the taxpayer and to lease it back from the taxpayer. The parties contend, however, that neither sales tax nor use tax applies because the transaction is really a financing transaction with the property serving as security for the loan.

If the taxpayer did not obtain ownership of the property such that the transaction was a financing transaction, the taxpayer would be engaged in business as a personal property broker under section 22009 of the Financial Code and would be required to hold a license issued by the Corporation Commissioner. If the taxpayer does not hold a license as a Personal Property Broker, it should be assumed that the taxpayer received title to the property, and the transaction is a sale and leaseback and not a financing transaction. 11/28/66.

330.5300 **Use of Property by Lessor.** A lessee failed to exercise its purchase option in the lease portion of a transaction qualifying as an ''acquisition sale and leaseback'' under section 6010.65. The lessor therefore retained ownership of the property. Since the lessor had acquired title to the property in a transaction not subject to sales or use tax (the acquisition sale and leaseback), its own subsequent use of the property is not subject to tax. However, any subsequent lease of the property by the lessor would be a continuing sale and purchase because the lessor would not have timely paid sales tax reimbursement or use tax on purchase price (and would have no election to do so). The subsequent leases would be subject to tax measured by rentals payable. 2/21/92.